1 CONSUMER PROTECTION ACT, 1986

HISTORICAL BACKGROUND

Consumer is the pivot of all production and progress of a nation. Unfortunately, Indian consumers are mostly illiterate and unorganised. They have little capacity to purchase goods or services on fair rates and terms. They are generally bluffed and befooled by the traders who are organised and commit frauds in open market. For the industrial development of the country. Sri Jawharlal Nehru initiated the restricted import policy to offer facilities to Indian industrialists in the interest of rapid development of Indian industries. But the Indian industrialists rather committed frauds with the Indian consumers by producing sub-standard products. Now as the central government has opened the gates of world market to Indian traders. Indian traders are making hue and cry as they are unable to compete with the foreign industrialists and traders. To protect the interests of Indian consumers, the former Prime Minister, Rajiv Gandhi initiated the Consumer Protection Act, 1986.

It was at the initiative of Rajiv Gandhi, a seminar was organized in New Delhi in January, 1986. The representatives of state governments, voluntary organizations of consumers and central ministers of different departments took part in the seminar and expressed their opinions on the issue of consumers, protection. Those suggestions were discussed and debated in a number of inter-ministerial meetings to prepare a draft bill on consumers' protection. In order to design the framework of proposed legislation on consumer protection, the existing laws of different countries, *viz.*, U.S.A., U.K., Australia, in respect of consumers' protection, were taken into account. The prevailing socio-economic condition of India also shape the paradigms of bill on consumers' protection. The bill was finally placed before Lok Sabha on 9th December, 1986 by Sri H. K. L. Bhagat. In introducing the bill he stated that the bill represented a land-mark in the field of socio-economic legislation of the country. This comprehensive bill would supplement and not replace any other law pertaining to consumer protection. The bill enshrines the

rights of the consumers to be protected by the consumer protection councils in the centre and states and the redressal machinery at the national, state and district levels. The legislation intends to provide prompt and meaningful remedy for consumers' grievances. But its success will depend on effective implementation of its provisions by the central and state government. There is no hesitation in saying that strong and broad-based voluntary consumer movement from the grass-root level holds the key to success. The Minister declared that, "I also take this opportunity to request my brethren in the trade and industry to rise to the occasion, set up consumers' redressal cells within their organizations which and would minimise consumers' complaints and improve their image. Trade and industry should not only envolve a code of Ethics for fair business practices but also implement them in letter and spirit."

STATEMENT OF OBJECTS

1. The Consumer Protection Bill, 1986 seeks to provide better protection of interests of the consumers and for that purpose to make provisions for establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith.

2. It seeks to promote and protect the rights of consumers, such as :

(*a*) The right to be protected against marketing of goods which are hazardous to life and property.

(*b*) The right to be informed about the quality, quantity, potency, purity, standard and price of goods to protect the consumer against unfair trade practices.

(*c*) The right to be assured, wherever possible, access of variety of goods at competitive prices.

(*d*) The right to be heard and to be assured that consumers' interests will receive due consideration at appropriate forums.

(*e*) The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers, and

(*f*) The right to consumer education.

3. To provide steady and simple redressal to consumers' disputes, a quasi-judicial machinery is sought to be set up at the district, state and central levels. The quasi-judicial bodies will

observe the principles of natural justices and have been empowered to give reliefs of a specific nature and to award wherever appropriate compensation to consumers. Penalties for non-compliance of the orders given by the quasi-judicial bodies have also been provided.

SALIENT FEATURES OF THE CONSUMER PROTECTION ACT, 1986

The salient features of the Act are as follows :

1. The Act provides speedy redressal to consumer complainants. The Bill provides for setting up of a Consumer Redressal Forum in every district, a commission at the state level and the National Commission at the Centre. The Forum in the District will have original jurisdiction to redress complaints up to claim of Rs. 1 lakh (after amendment up to 10 lakhs). The State Commission will have original jurisdiction to settle claims up to the amount Rs. 10 lakhs after amendment 20 lakhs). The National Commission can entertain any claim for damages above Rs. 10 lakhs (after amendment above 20 lakhs). The State Commission will be vested with appropriate Appellate and Revisional powers.

2. To promote voluntary consumer movement and to ensure involvement of consumers. The Bill provides for the establishment of Consumer Protection Councils in centre and the states. These Councils will have both non-official and official members. The objects of the Councils will be to promote and protect the rights of the consumers.

3. It shall apply to all goods and classes of goods or all services or classes of services except those which are specially exempted by notification by the central government.

4. The provisions of the Bill shall be in addition to and not in derogation of any other law for the time being in force.

5. Necessary penal and punitive provisions have been corporated to ensure that the proposed legislation is effective in protecting consumers.

6. The complaint can be filed by a consumer or an organization being a society registered under the Societies Registration Act, or a company registered under the Companies Act, representing consumers or by the central or state government.

7. The complaint can be filed on account of any unfair trade practices resulting in loss or damage, defect in the goods, deficiency in the services, prices charged in excess of the prices fixed by or under any law or displayed on the goods/packets.

DEFINITION OF CONSUMERS

Consumer, under section 2(1)(d) of the Consumer Protection Act, 1986, means one who pays money for goods or services. In other words, a consumer is a specific person who pays money either for purchase of some goods or some service of other person, individual or corporate body. The definition under section 2(1)(d)(i) does not include a person who obtains such goods for resale or for any commercial purposes. But "Commercial purpose" under sub-clause (i) above does not include use by a consumer of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment.

In *Mrs. S Anusuya* v. *M/s Methodax Systems (P) Ltd.*, (1991), it was observed that "Parliament intended to restrict the benefits of the Act to ordinary consumers purchasing goods either for their own consumption or even for use in small ventures which they have embarked upon in order to make living as district from a larger scale manufacturing or private activity carried on for profit in order that exclusive clauses should apply. It is, however, necessary that there should be a close nexus between the transaction of the purchase of goods and the large-scale activities carried on for earning deposits."

Service means service of any description which is made available to potential users and includes the provisions of facilities in connection with banking, financing, insurance, transport, processing supply of electrical or other energy, boarding or lodging or both, housing construction, entertainments, amusement or the news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

CONSUMER DISPUTES

Consumer dispute is a dispute which arises out of a denial of allegation complained in a complaint by the person against whom such complaint has been made. For definition of the term

'Complaint', it is an allegation in writing made by a consumer or a voluntary consumer association duly registered or by the central government or the state government. Disputes means a claim made by one party and denied by the other. In Dacca Cooperative Industrial Union Ltd. v. Dacca Cooperative S. S. Samity, it was held that a proceeding to recover money arising out of a claim asserted by one party and denied by other party is a dispute. The allegation to give rise to a consumer dispute within the meaning of the definition given in Consumer Protection Act includes allegation in respect of unfair trade practices, defects in goods, deficiency in service and charging of excessive price.

CONSUMER PROTECTION COUNCILS

Central Council and State Councils

The Consumer Protection Act, 1986 sought to provide better protection to the interests of the consumers and for that purpose made provisions for the establishment of Consumer Protection Councils and other authorities for resolving consumers' disputes. The Consumer Protection Councils would be set up at national and state levels (Section 6 of Consumer Protection Act)

The objects of the Central Consumers Protection Council and State Consumers Protection Councils are to promote and protect the rights of the consumers, such as :

(*a*) The right to be protected against marketing of goods and services which are hazardous to life and property.

(*b*) The right to be informed about the quality, quantity, potency, purity, standard and price of goods or services as the case may be so as to protect the consumer against unfair trade practices.

(*c*) The right to be assured wherever possible, access to a variety of goods and services at competitive prices.

(*d*) The right to be heard and to be assured that consumers' interest will receive due consideration at appropriate forum.

(*e*) The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers, and

(*f*) The right to consumer education.

The objects of a State Consumer Protection Council are to

promote and protect within the state the rights of the consumers.

The objects of the Central Consumer Protection Council are to promote and protect the rights of the Indian consumers in general within the territory of India. The Central Council is the highest body to lay down and decide the policy of consumer protection. Consumers' interests mainly concern with

(*i*) good quality of goods and services.
(*ii*) regular and uninterrupted supply of products; and
(*iii*) reasonable prices of the products.

COMPOSITION AND FUNCTIONS OF THE COUNCILS

Central Council (*Sec. 4*)

The Central Council will be composed of following members :

1. The Minister in charge of Consumer Affairs of the union government will be the chairperson of the Council.
2. Such members—official and non-official—representing such interests as may be prescribed.

The Central Council meets as and when necessary. At least one meeting shall be held every year. The time and place of the meeting will be fixed by the Chairman. The procedure in regard to the transactions of the business shall also be determined by the Chairman. (Sec 5).

State Council (*Sec. 7*)

A State Council shall be composed of the following members, namely,

1. The Minister in charge of Consumer Affairs of the state government will act as Chairman.
2. Such members—official and non-official—representing such interests as may be prescribed by the state government.

The State Council shall meet as and when necessary. The time and place of the meeting shall be fixed by the Chairman. The Council shall observe such procedure in regard to the transactions of its business as may be prescribed by the state government. At least two meetings shall be held every year.

REDRESSAL AGENCIES PROVIDED UNDER THE CONSUMER PROTECTION ACT

To provide steady and simple redressal to consumer disputes a quasi-judicial machinery has been set up at the district, state and central levels. The quasi-judicial bodies observe the principle of natural justice and have been empowered to give reliefs of a specific nature and to award wherever appropriate, compensation to consumers. Penalties for non-compliance of the orders given by the quasi-judicial bodies have also been provided. (Sec. 9)

The Consumer Protection Act provides for the following redressal agencies

(*a*) A Consumer Dispute Redressal Forum known as District Forum has to be set up by the state government by notification in each district.

(*b*) A Consumer Disputes Redressal Commission to be known as the State Commission would be established by the state government with the approval of the central government.

(*c*) A Consumer Redressal Commission to be known as the National Commission has been established by the Central Government.

DISTRICT FORUM

Composition (*Sec. 10*)

Each District Forum consists of

(*a*) A person who is or has been, or is qualified to be a District Judge to be nominated by the state government as its President.

(*b*) a person of eminence in the field of education, trade or commerce,

(*c*) a lady social worker.

However, every appointment shall be made by the state government on the recommendation of Selection Committee consisting of the following :

1. President of the State Commission who acts as Chairman,

2. Secretary, Law Department of the state government as a Member.

3. Secretary in charge of the Department dealing with consumer affairs in the state as a member.

The salary or honorarium and other allowances payable to and the other terms and conditions of service of the members shall be such as may be prescribed by the state governmen*. Every member of the District Forum shall hold office for a term of 5 years or upto age of 65 years, whichever is earlier shall not be eligible for re-appointment.

Jurisdiction of the District Forum (*Sec. 11*)

By jurisdiction is meant the authority which is vested in a court. In other words, jurisdiction means

1. the power, right or authority to take cognizance and decide any matter according to law and,

2. the limits or territory within which authority may be exercised.

The District Forum has the jurisdiction to entertain complaints where the value of the goods or services and the compensation of any does not exceed Rs. 10 lakhs.

A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction.

(*a*) the opposite party or each of the opposite parties resides or carries on business.

(*b*) the cause of action arises.

Powers of the District Forum

The District Forum shall have the same powers as vested in Civil Court under the Code of Civil Procedure, 1908, while trying to suit in respect of the following matters :

(*i*) summoning and enforcing attendance of any defendant or witness and examining the witness or oath ;

(*ii*) the discovery and production of any document or other material object predictable as evidence ;

(*iii*) the reception of evidence on affidavits ;

(*iv*) the requisitioning of the report of the concerned analysis or from the appropriate laboratory or from any other relevant source ;

(*v*) issuing of any commission for the examination of any-witness and ;

(*vi*) any other matter which may be prescribed.

Every proceeding before the District Forum shall be deemed to be judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code, 1860 and the District Forum shall be deemed to be Civil Court for the purpose of Section 195 and Chapter XXVI of the Code of Criminal Procedure,1973 for launching inquiry regarding giving false evidence in the Forum.

STATE COMMISSION

Composition (*Sec. 16*)

Under Section 16 of the CP Act, 1986 a State Commission is to be composed of :

1. A president who is appointed by the state government in consultation with the Chief Justice of High Court. The person so appointed is or has been a judge of High Court.

2. Two other members, who shall be persons of ability, integrity and standing and have adequate knowledge or experience, or have shown capacity in dealing with problems relating to economies, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

But every appointment must be made by the state government on the recommendation of the Selection Committee. The Selection Committee shall consist of :

(*i*) President of the State Commission as Chairman.

(*ii*) Secretary of the Law Department of the state as one member.

(*iii*) Secretary in charge of the Department dealing with consumer affairs in the state as other member.

The salary or honorarium and other allowances payable to and the other terms and conditions of service of the members of the State Commission will be such as may be prescribed by the state government. Every member of the State Commission shall hold office for a term of 5 years or upto age of 67 years, whichever is earlier and shall not be eligible for re-appointment.

Jurisdiction and Powers of the State Commission

Pecuniary Jurisdiction

The State Commission shall have jurisdiction to entertain appeals against the order of District Forum within the state where

the value of the goods or services and compensation, if any, excludes Rs. 5 lakhs but does not exceed Rs. 20 lakhs.

Terminal Jurisdiction of the State Commission

The State Commission has been entrusted with territorial jurisdiction over the whole territory of the concerned state. It may entertain the cases, the valuation of which is more than Rupees 5 lakhs and less than 20 lakhs. It shall have jurisdiction to entertain appeals against the orders of any District Forum within the State, and to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the state, where it appears to the State Commission that such District Forum has exercised a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity. In other words, the State Commission has appellate as well as revisional jurisdiction over the whole territory of the state concerned.

Original Jurisdiction

Any person aggrieved, regarding the valuation of more than rupees 5 lakhs and less than 20 lakhs, may file a complaint before the State Commission in whose territory the cause of action arose or the opposite party resides or works for gain.

The procedure for entertaining and disposal of complaints to be followed before the State Commission shall be the same as provided for complaints before District Forum in sections 12, 13 and 14 and the rules made thereunder, by the concerned State Commission with such modifications as may be necessary as per Section 18.

Appellate Jurisdiction

Any person aggrieved by an order made by the District Forum may prefer an appeal against such order to the State Commission. An appeal to the State Commission can be filed within a period of 30 days from the date of the orders, in such a form and manner as may be prescribed under Section 15 of the Act. The State Commission may, however, entertain an appeal after the expiry of the period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period.

In it was observed Rajasthan Housing Board Vs. Smt. Shashi Sinwal that it is incumbent on appellant who has to explains each

day of default beyond the terminus line of the prescribed period of limitation.

Revisional Jurisdiction

Even when an appeal is time bound, the State Commission can exercise powers of revision to set aside order appealed against if there was an error of jurisdiction committed by the District Forum. The State Commission may call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the state, where it appears to the State Commission that such District Forum has exercised a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity.

The grounds for the revision application are the same as are provided for a civil revision in the Code of Civil Procedure. On presentation of such application, the Commission may either dispose it of summarily or order to send for record of the District Forum in the matter and decide the revision application after giving opportunity to the opposite party to be heard.

THE NATIONAL COMMISSION

Under Section 20 of the C. P. Act 1986 The National Commission is composed of following members :

1. A person who is or has been a judge of Supreme Court appointed by the Central Government in consultation with the Chief Justice of India, who shall be its President.

2. Four other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration. One of them shall be a woman.

Appointment of these four members shall be made by the Central Government on the recommendation of a Selection Committee composed of the following, namely.

(*a*) Chairman who happens to be judge of Supreme Court and nominated by the Chief Justice.

(*b*) Two other members—one of them happens to be Secretary in the Department of Legal Affairs, the Government of India and the other member happens to be the Secretary of

the Department dealing with Consumer Affairs ; Government of India.

Every member of the National Commission shall hold office for a term of five years or upto the age of seventy years, whichever is earlier and shall not be eligible for reappointment.

Jurisdiction ***(Sec. 21)***

The National Commission will have the jurisdiction to entertain any complaint directly where the value of the goods exceeds Rupees 20 lakhs. It also entertains appeals against the orders of any State Commission. Besides, it has the jurisdiction to call for records and pass appropriate orders in any consumer dispute which is pending or decided by the State Commission in a wrong way or with material irregularity.

Power and Procedure

The National Commission will have the powers of a Civil Court as specified in sub-sections (4), (5) and (6) of section 13, such as, summoning and enforcing attendance of the defendant, examination of witness, urging production of documents, requisitioning of the report of the concerned analysis or test from the appropriate laboratory, order issuing of any commission for examination of any witness. Every proceeding before the National Commission will be deemed to be judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code, and the National Commission will be deemed to be a Civil Court for the purpose of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Moreover, the National Commission has the power the direct the defendant to remove the defects of the goods as detected by the appropriate laboratory, to replace the goods, to return the price, to remove the defects or deficiencies of the services in question, to discontinue the unfair or restricted trade practices and so on as referred in clauses (a) to (f) of sub-section (1) of section 14.

Appeal

Any person, aggrieved by an order of National Commission may prefer an appeal against such order to the Supreme Court within a period of 30 days from the date of the order. If no appeal

has been preferred against such order, the order passed by the National Commission will be final.

Administrative Control

The National Commission will have administrative control over all the State Commission, such as, calling for periodical return regarding the institution, disposal, pending of the cases. National Commission also issues instruction regarding adoption of uniform procedure e c. It also watches the functioning of the State Commission or of the District Forums to ensure that the objects and purposes of the Act are best served without in any way interfering with their quasi-Judicial freedom.

Enforcement of Order

Every order made by the National Commission will be enforced by the Commission in the same manner as if it were decree or order made by a Court.

COMPLAINT

What it is ?

Complaint means any allegation made in writing by the complainant that—

1. As a result of any unfair trade practice adopted by any trade, he has suffered loss or damage.
2. The goods mentioned in the complaint suffer from one or more defects.
3. The services mentioned in the complaint suffer from deficiency in any respect, and
4. Price in excess of price fixed by or under any law for the time in force or displayed on the goods or any package containing such goods has been charged by a trader. The purpose of the complaint is to seek certain relief.

Procedure on receipt of Complaint

It has been provided in Section 13 of the Act that the District Forum shall on receipt of a complaint, if it relates to any goods, refer a copy of the complaint to the opposite party mentioned in the complaint directing him to give his version of case within a period of 30 days or such extended period not exceeding 15 days as may be granted by the District Forum. Where the opposite

party denies or disputes allegation or omits or fails to take any action within the time given, the District Forum shall proceed to settle the dispute.

Where the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the District Forum shall obtain a sample of the goods from the complainant seal it and authenticate it in the manner prescribed and refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory make analysis or test, whichever may be necessary with a view to finding out whether such goods suffer from any defect alleged in the complaint or suffer from any defect and to report its finding thereon to the District Forum within a time period of 45 days of the receipt of the reference or within such extended period as may be granted by the District Forum.

Before any sample of the goods is referred to any appropriate laboratory, the District Forum may require the complainant to deposit to the credit of the Forum such fees as may be specified, for payment to the laboratory for carrying out the necessary analysis or test in relation to the goods in question.

The District Forum shall remit the amount so deposited to its credit to the appropriate laboratory to enable it to carry out the analysis or test mentioned above and on receipt of the report from the appropriate laboratory, the District Forum shall forward a copy of the receipt along with the remarks as the District Forum may feel appropriate to the opposite party.

It any of the parties disputes the correctness of the findings of the appropriate laboratory or disputes the correctness of the methods of analysis or test adopted by the laboratory, the District Forum shall require the opposite party or the complainant to submit in writing his objectives in regard to the report made by the appropriate laboratory. The District Forum thereafter shall give a reasonable opportunity to both the parties of being heard on the point of correctness or otherwise of the report and also as to the objection made in relation thereto and issue an appropriate order.

If the complaint received by it relates to goods in respect of which the procedure specified above cannot be followed, or if the complaint relates to any services, the District Forum shall refer a copy of such complaint to the opposite party directing

him to give the version of the case within a period of 30 days or such extended period not exceeding 15 days as may be granted by the District Forum.

Where the opposite party denies or disputes the allegation or omits or fails to take any action to represent his case within the time given by the District Forum, the District Forum shall proceed to settle the disputes on the basis of the evidence brought to the notice by the complaimant and the opposite party. No proceeding complying with the procedure mentioned above shall be called in question on the ground that the principles of natural justice have not be complied with.

FINDINGS OF THE DISTRICT FORUM

If, after the proceeding conducted under section 13, the District Forum is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to take one or more of the followings :

(*a*) to remove the defects pointed out by the laboratory from the goods in question ;

(*b*) to replace the goods with new goods of similar description which shall be free from any defect ;

(*c*) to return to the complainant the price, or, as the case may be the charges paid by the complainant ;

(*d*) to pay such amount as may be awarded by it as compensation to the consumer due to negligence of the opposite party ;

(*e*) to remove the defects or deficiencies in the services in question ;

(*f*) to discontinue the unfair trade practice or the restricted trade practice or not to repeat them ;

(*g*) not to offer the hazardous goods for sale ;

(*h*) to withdraw the hazardous goods from being offered for sale ;

(*i*) to provide for adequate costs to parties.

Every order made by the District Forum shall be signed by all the members constituting it. Procedure relating to the conduct of the meetings of the District Forum, its sitting and other matter shall be such as may be prescribed by the state government.

PENALTY UNDER THE C. P. ACT.

Section 27 of Consumer Protection Act, 1986 provides for penalties that, where a trader or a person against whom a complaint is made or the complainant fails or omits to comply with any order made by the District Forum, the State Commission or the National Commission, as the case may be, such trader or person or complainant shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to three years, or with fine which shall not be less than Rs. 2000/- but which may extend to Rs. 10000/- or with both. But the District Forum, the State Commission or the National Commission, as the case may be, if it is satisfied that the circumstances of the case so require, impose a sentence of imprisonment or fine, or both for a term lesser than the minimum term and the amount lesser than the minimum amount, specified in this section.

EXERCISES

1. Define the topics listed below as stated under the Consumer Protection Act. (*a*) Consumer (*b*) Service (*c*) Complaint (*d*) Consumer Dispute. [Pages (*a*) 519 (*b*) 519 (*c*) 528 (*d*) 519]
2. State the composition and objective of Central Consumer Protection Council. (Page 521)
3. State the composition and objective of State Consumer Protection Council. (Page 524)
4. Discuss the principles laid down under the Consumer Protection Act, regarding composition and jurisdiction of District Forum. (Page 522)
5. Discuss the process regarding complaint under the Consumer Protection Act. (Page 528)
6. Discuss the procedures on settlement of disputes on receipt of complaint. (Page 528)
7. Write short notes :
   (*a*) Complainant (*b*) Defect (*c*) Trader (*d*) Dispute (*e*) Unfair trade practice. [Pages (*a*) 528 (*b*) 518 (*c*) 519 (*d*) 519 (*e*) 519]
8. Discuss about the penalties under the Consumer Protection Act. (Page 531)

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1 INTRODUCTION

GENESIS OF THE COMPANIES ACT, 1956

The first Indian Act, regarding companies, was the Joint Stock Companies Act of 1850. This was based upon the English Act of 1844. The Act of 1850 was replaced by a new Act bearing the same name in 1857. In this Act the principle of limited liability was introduced for the first time in India. With the growing popularity of the corporate form of business organisation, need was felt for more comprehensive company legislation, Acts relating to companies were passed in 1860, 1866, 1882, 1895, 1910 and 1913. The act of 1913 remained in force up to 1956, though it was extensively amended in 1936, 1951, 1984 and 1988.

The Government appointed in 1950, an expert committee under the chairmanship of Sri C. H. Bhaba to suggest how the Company Law can be reformed. The Companies Act of 1956 (Act 1 of 1956) is based mainly on the recommendations of the committee. The Act of 1956 has been amended in 1960, 1963, 1965, 1969, 1971, 1974, 1984 and 1988.

OBJECTS AND PURPOSES OF COMPANY LEGISLATION

The Company is a form of business organisation in which the funds of a large number of investors are managed by a few persons for the purpose of earning profits which are shared by all the investors. The main objects and purposes of statutes relating to companies are as follows :

1. Encourage investments in companies by providing certain facilities, e.g., limitation of liability, transferability of shares etc.

2. Ensure due and proper administration of the funds and assets of companies in the interest of the investing public.

3. Present malpractices by directors and managers.

4. Arrange for investigation into the affairs of companies and provide for effective audit in dealing with cases of dishonesty and fraud in the corporate sector.

EXTENT AND APPLICATION

The Companies Act extends to the whole of India : Provided that it shall apply to the state of Nagaland subject to such modifications, if any, as the Central Government may, by notification in the official Gazette specify.—Sec.1(3).

The Central Government can modify the Act in its application to Nidhis or a Mutual Benefit Society, subject to issuing notification on this subject.—Sec. 620A.

Subject to issuing a notification, the Central Government can modify and provide special provisions as to companies in Goa, Daman and Diu.—Sec. 620B.

The same provisions have been applied to Jammu and Kashmir.—Sec. 620C.

The Act applies to all classes of companies including public companies, private companies and associations not trading for profit. It also includes provisions in respect of companies incorporated outside India, but which have an established place of business in India.

WHAT IS A COMPANY ?

Definition

The term Company is used to describe an association of a number of persons, formed for some *common purpose* and *registered* according to the law relating to companies. Section 3(1)(i) of the Companies Act, 1956 states that a company means, "a company formed and registered under this Act or an existing company."

Lord Justice Lindley defines a company as follows : "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share."

Explanation

A company, formed and registered under the Companies Act, is regarded by law as a single person, having specified rights

and obligations. The law confers on a company a distinct legal personality, with perpetual succession and a common seal. *Therefore a company is different from its members and the individuals composing it.* Suppose that, *A, B, C* and 50 other persons form a company called XY & Co. The Company, XY & Co. is a legal person quite separate from *A, B, C* and others. Therefore, *A, B, C* etc. can enter into contracts with XY & Co.

Illustration

This principle is illustrated in the case *Salomon* v. *Salomon & Co. Ltd.*[1] Salomon had a business in boot manufacture. He formed a company called Salomon & Co. (with himself, his wife, daughter and 4 sons as shareholders) and transferred to it his business. As consideration for the transfer he received the major portion of the shares of the company and debentures for £ 10,000. Later on, the company went into liquidation. Salomon, as a debenture holder, claimed to be a secured creditor and demanded priority in the payment of £ 10,000, out of the assets of the company. The unsecured creditors of the company objected on the ground that the business really belonged to Salomon and he should not be allowed to claim as a secured creditor. It was held that Salomon as an individual, was quite distinct from Salomon & Co. and he could therefore be a secured creditor of the company, even though he happened to hold the majority of the shares.

One-man Company or Family Company

Even when a single person holds most of the shares of a company, the company has a legal personality separate and distinct from the owner of the majority of the shares. A person can form a company by getting a few nominees or dummies, get registration and commence business. *Salomon* v. *Salomon & Co. Ltd.* (See above). *E. B. M. & Co. Ltd.* v. *Dominion Bank.*[2] Such a company, can be called a one-man company or individual ownership of a company.

Statutory Company

A company or corporation, formed by an Act of the Legislature, is called Statutory Corporation. Examples are Reserve

[1] (1897) A.C. 22 [2] AIR (1937) Privy Council 279

Bank of India, Industrial Finance Corporation, Life Insurance Corporation etc. The constitution and functions of such companies are laid down by the Act of Parliament or any State Legislature of India. Statutory companies are created and organised for specific public undertakings.

Chartered Company

Formerly in Great Britain, companies were formed by Royal Charter for specific purpose, *e.g.*, East India Company. A Chartered Company is regulated by the terms of its Charter. In India such companies are foreign companies.

Registered Company

A company must be registered under the Companies Act. After registration, the Registrar of the companies issues a Certificate of Incorporation. After that the company becomes a Registered Company. (See ch. 3).

Unregistered Company

If an association or company is not registered it should be called unregistered company. (See 'illegal Association', p. 556). The Companies Act provides, under section 582, for the winding up of unregistered company. (See at the end of chapter 11)

Government Company and Foreign Company See pp. 557-559

ESSENTIAL FEATURES OF A COMPANY

The principal characteristics of an incorporated company can be summarised as follows :

1. *Registration* : A company comes into existence only after registration under the Companies Act. But a Statutory Corporation is formed and commence business as notified or stated in the Act and as passed in the Legislature. In case of partnership, registration is not compulsory.

2. *Voluntary Association* : A company is an association of many persons on a voluntary basis. Therefore a company is formed by the choice and consent of the members.

3. *Legal personality* : A company is regarded by law as a single person. It has a legal personality. This rule applies even in the case of "One-man Company." *Salomon* v. *Salomon & Co.* (ibid.).

4. *Contractual capacity* : A shareholder of a company, in its individual capacity, cannot bind the company in any way. The shareholder of a company can enter into contract with the company and can be an employee of the company.

5. *Management* : A company is managed by the Board of Directors, whole time Directors, Managing Director or Manager. These persons are selected in the manner provided by the Act and the Articles of Association of the company. A shareholder, as such, cannot participate in the management.

6. *Capital* : A company must have a capital, otherwise it cannot work.

7. *Permanent existence* : The company has Perpetual Succession. The death or insolvency of a shareholder does not affect its existence. A company comes into end only when it is liquidated according to provisions of the Companies Act.

8. *Registered Office* : A company must have a registered office.

9. *Common Seal* : A company must have a Common Seal.

10. *Limited Liability* : The liabilities of shareholder of a company are usually limited. The creditors of a company are not creditors of individual shareholders and a decree obtained against a company cannot be executed against any shareholders. It can only be executed against the assets of the company.

11. *Transferability* : The shareholder of a company can transfer its share and ordinarily the transferee becomes a member of the company.

12. *Statutory Obligations* : A company is required to comply with various statutory obligations regarding management, *e.g.*, filing balance sheets, maintaining proper account books and registers etc.

13. *Not a citizen* : A company is an artificial person, not a natural person. Therefore a company is not a Citizen, although it may have a Domicile. *State Trading Corporation of India* v. *C. T. O.*[1] *Divisional Forest Officer* v. *Bishwanath Tea Co. Ltd.*[2]

14. *Residence* : A company has a residence (for taxation and other purpose). A company does not possess any fundamental rights. *Tata E. & L. Co. Ltd.* v. *State of Bihar.*[3]

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[1] AIR (1953) Supreme Court 1811 [2] AIR (1981) Supreme Court 1368
[3] AIR (1965) Supreme Court 40

15. *No fundamental rights*: Though a company has no fundamental rights, it can challenge a law as void if the law happens to violate fundamental rights of citizens. In order to succeed the company must prove that the impugned law is expropriatory of a citizen's property. *Prithvi Cotton Mills* v. *Broach Borough Municipality.*[1]

"It is true that the Statesman newspaper being a Company has no fundamental rights. But the fundamental rights of the shareholders of the Company as citizens are not lost when they associate to form a company. The shareholders' rights are equally and necessarily affected if the rights of the Company are affected." *Statesman Ltd. and others* v. *Fact Finding Committee and others.*[2]

16. *Social Objective*: The present view as regard the legal nature of Company Law is that the Company is a social institution having duties and responsibilities toward the community, its workers, the national economy and progress. (See next topic).

17. *Centrally Administrated*: The administration of Company Law is entrusted to the Central Government. (See chapter 10).

18. *"Lifting the veil" of the company*: See ch. 10.

Is a Company a Property of the Shareholders ?

The new Concept of Company. There has been a considerable debate as to whether a Company is the property of the shareholders. In the case, *National Textile Workers' Union* v. *P. R. Ramakrishnan*[3] the views of Supreme Court are quoted below :

It is now accepted on all hands, even in predominantly capitalist countries, that a company is not property. The traditional view that the company is the property of the shareholders is now an exploded myth. A company according to the new socio-economic thinking, is a social institution having duties and responsibilities towards the community in which it functions. Maximisation of social welfare should be the legitimate goal of a company and shareholders should be regarded not as proprietors of the company, but merely as suppliers of capital entitled to no more than reasonable return and the company should be responsible not only to shareholders but also to workers, consumers and the other members of the community and should be guided by considerations of national economy and progress.

[1] AIR (1968) Guj. 124 [2] AIR (1975) Cal 14
[3] AIR (1983) Supreme Court 75

COMPANY AND PARTNERSHIP

The points of difference between a Partnership and a Company can be summed up as follows.

A company is regulated in accordance with the Companies Act, 1956 and its subsequent amendments, while a partnership is regulated by the Indian Partnership Act, 1932.

1. *Registration* : A company comes into existence only after registration under the Companies Act. Ir the case of a partnership, registration is not compulsory.

2. *Minimum number of members* : The minimum number of persons required to form a company is 2 in the case of private companies and 7 in the case of public companies. The minimum number of persons required to form a partnership is 2.

3. *Maximum number of members* : A public company may have any number of members. A private company cannot have more than 50 members. A partnership carrying on banking business cannot have more than 10 members and partnership carrying on other types of business cannot have more than 20 members.

4. *Legal status* : A company is regarded by law as a single person. It has a legal personality. A partnership is a collection of individuals. It is not considered to be a single person.

5. *Authority of members* : The property of a partnership is the joint property of the partners. Each partner has authority to bind the firm by his acts. The property of the company belongs to the company. A shareholder in his individual capacity cannot bind the company in any way.

6. *Contractual capacity* : The shareholder of a company can enter into contracts with the company and can be an employee of the company. Partners can contract with other partners but not with the firm as a whole.

7. *Management* : A partnership firm is managed by the partners themselves. The work of management can be distributed among them in any manager they like.

A company is managed by the Board of Directors or Whole Time Directors or Managing Directors or Manager who are selected in the manner provided by the Act. A shareholder, as such, cannot participate in the management.

8. *Length of existence* : A company has perpetual succession. The death or insolvency of a member does not affect its existence.

It comes to an end only when liquidated according to the provisions of the Companies Act. A partnership, in the absence of a contract to the contrary, comes to an end when a partner dies or becomes insolvent.

9. *Liability of members*: The liability of the members of a partnership for the debts of the firm is unlimited. The liability of the members of a company is limited.

10. *Liability of firm and company*: The creditors of a firm are creditors of the individual partners, and a decree obtained against a firm can be executed against the individual partners. The creditors of a company are not creditors of the individual shareholders and a decree obtained against a company cannot be executed against any shareholder. It can only be executed against the assets of the company.

11. *Transferability*: A partner of a firm cannot transfer his interest in the firm to an outsider and make the transferee a partner without the consent of all the other partners. The shareholder of a company can ordinarily transfer his share and the transferee becomes a member of the company.

12. *Statutory obligations*: A company is required to comply with various statutory obligations regarding management, *e.g.*, filing balance sheets, maintaining proper account books and registers. In the case of partnership there are no such statutory obligations.

TYPES OF COMPANIES

There are two types of companies—Public and Private.

1. Private Company

A private company is one which, by its articles, (*a*) restricts the right of the members to transfer their shares, if any; (*b*) limits the number of its members (not counting its employees) to 50; and (*c*) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company.—Sec. 3(1)(iii).

Where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member.

2. Public Company

All companies other than private companies are called public companies.—Sec. 3(1)(iv).

Public companies may be classified into three types : (*i*) companies limited by shares, (*ii*) companies limited by guarantee, and (*iii*) unlimited companies.

Private companies may be limited by shares or limited by guarantee. There cannot be a private company with unlimited liability.

Company Limited by Shares

In these companies there is a share-capital, and each share has a fixed nominal value which the shareholder pays at a time or by instalments. The member is not liable to pay anything more than the fixed value of the share, whatever may be the liabilities of the company. Most of the companies in India belong to this class.

Company Limited by Guarantee

In these companies, each member promises to pay a fixed sum of money in the event of liquidation of the company. This amount is called the Guarantee. Sometimes the members are required to buy a share of a fixed value and also give a guarantee for a further sum in the event of liquidation. There is no liability to pay anything more than the value of the share (where there is a share) and the guarantee.

Unlimited Company

In these companies the liability of the shareholder is unlimited, as in partnership firms. Such companies are permitted under the Companies Act but are not known.

Statutory Public Company See p. 552

Non-Profit Associations

The Central Government may by licence, permit the omission of the words Limited or Private Limited in the case of companies which are formed for promoting commerce, art, science, religion, charity or any other useful object, and which are non-profit and non-dividend-paying organisations (e.g., Chambers of Commerce). The licence given may be withdrawn if the company ceases to fulfil the conditions mentioned above.—Sec. 25.

At the time of granting the registration of such an association, the Central Government can provide restrictions on their working.

The Government can direct the inclusion of the restrictions in the memo and the articles of association of the institution. After registration its members can get all the benefits of the Companies Act, including limited liability. The Central Government can exempt any of the restrictions by a general or a special notification.

BODY CORPORATE OR CORPORATION

"Body Corporate" or "Corporation" includes a company incorporated outside India but does not include—(*a*) a corporation sole ; (*b*) as co-operative society registered under any low relating to co-operative societies ; and (*c*) any other body corporate (not being a company as defined in this Act) which the Central Government may, by notification in the official Gazette, specify in this behalf.—Sec. 2(7).

The term Body Corporate or Corporation is used in a special sense. It includes companies incorporated outside India. It does not include a co-operative society under any law relating to such societies. It does not include a corporation sole.

Corporations are of two types *viz.*, Corporation Aggregate and Corporation Sole. The former is formed by a group of persons for the performance of a common object *e.g.*, an incorporated company. The latter, *i.e.*, a corporation sole is formed by one member at a time. A Kingship in England or President of India is a Corporation Sole. *Examples* : When a king dies another person becomes king and when the President of India dies or retires another President is elected. Thus in a Corporation Sole one person succeeds another person.

EXISTING COMPANY

Existing Company means a company formed and registered under any of the previous company law specified below—

(*a*) Any Act or Acts relating to companies in force before the Indian Companies Act, 1866 and repealed by that Act :

(*b*) The Indian Companies Act, 1866 ;

(*c*) The Indian Companies Act, 1882 ;

(*d*) The Indian Companies Act, 1913 ;

(*e*) The Registration of Transferred Companies Ordinance, 1942 ; and

(*f*) Any law corresponding to any of the Acts or the Ordinance aforesaid and in force—

(1) in the merged territories or in a Part B State (other than the State of Jammu and Kashmir), or any part thereof, before the extension thereto of the Indian Companies Act, 1913 ; or

(2) in the State of Jammu and Kashmir, or any part thereof, before the commencement of the Jammu and Kashmir (Extension of Laws) Act, 1956.—Sec. 3(1)(ii).

GROUP

"Group" means a group of two or more individuals, associations, firms or bodies corporate, or any combination thereof, which exercises or is in a position to exercise, or has the object of exercising, control over any body corporate, firm or trust.—Sec. 2(18A).

Explanation—The Company Law Board will decide whether he term 'group' comes within the above definition or not. The Board must give a reasonable opportunity of being heard to the ndividuals, associations, firms, bodies corporate or any ombination thereof.

The above provision was inserted in the Companies Amendment) Act, 1974.

PUBLIC FINANCIAL INSTITUTIONS

"4A. (1)—Each of the financial institutions specified in this ubsection shall be regarded, for the purposes of this Act, as public financial institution, namely—

(*i*) The Industrial Credit and Investment Corporation of India Limited, a company formed and registered under the Indian Companies Act, 1913 ;

(*ii*) the Industrial Finance Corporation of India, established under section 3 of the Industrial Finance Corporation Act, 1948 ;

(*iii*) the Industrial Development Bank of India established under section 3 of the Industrial Development Bank of India Act, 1964 ;

(*iv*) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956 ;

(*v*) the Unit Trust of India, established under section 3 of the Unit Trust of India Act, 1963.

(2) Subject to the provisions of sub-section (1), the Central Government may, by notification in the official Gazette, specify such other institution as it may think fit to be a public financial institution.

Provided that no institution shall be so specified unless—

(*i*) it has been established or constituted by or under any Central Act, or

(*ii*) not less than fifty-one per cent of the paid-up share capital of such institution is held or controlled by the Central Government."

The above section was added by the Companies (Amendment) Act, 1974.

Classification on the Basis of Control : In accordance with the basis of Control, Companies may be classified into—

(1) Holding Company ;

(2) Subsidiary Company.

HOLDING COMPANY AND SUBSIDIARY COMPANY

If a company can control the policies of another company (*i*) through the ownership of its shares or (*ii*) through control over the composition of its Board of Directors, the former (*i.e.*, the *controlling* company) is called a Holding Company and the latter (*i.e.*, the *controlled* company) is called its Subsidiary.

Sec. 4 of the Act lays down that a company shall be deemed to be a subsidiary of another company *only if* any one or more of the following conditions are satisfied :

(*a*) If the composition of its Board of Directors is controlled by the other company.

(*b*) (1) If it is an existing company in which the holders of preference shares (issued before the commencement of the Act of 1956) have the same voting rights as the holders of equity shares, and the other company exercises or controls more than half of the total voting power of such company ; or

(2) in any other case, if the other company holds more than half in nominal value of its equity share capital.

(*c*) If it is the subsidiary of a company which is itself the subsidiary of another company. [See example (3) below.]

The following points are to be noted :

1. The composition of a Company's Board of Directors shall be deemed to be controlled by another company if that other company can appoint or remove the holders of all or a majority of the directorship.—Sec. 4(2).

2. In determining whether one company is a subsidiary of another, the shares held in a fiduciary capacity or as security for a loan or by virtue of any provision in any debentures, shall not be counted. But shares held as a nominee shall he counted, except in the three cases mentioned above (in a fiduciary capacity etc.).—Sec. 4(3).

3: A foreign company may be treated as a subsidiary under certain circumstances.—Sec. 4(6) and 4(7).

Examples :

(1) *X* Co. holds 55 shares of *Y* Co. The subscribed shares of *Y* Co. consist of 100 shares. *X* Co. is a holding company and *Y Co.* is its subsidiary.

(2) *P Co.* holds 20 shares of *Q* Co. The subscribed share capital of *Q Co.* consists of 50 shares. By an agreement between the companies *P Co.* has the power to appoint 3 directors in *Q* Co. The articles of *Q.* Co. provides that there shall be only 4 directors. *P* Co. is a holding company and *Q* Co. is its subsidiary.

(3) If company *A* has a subsidiary *B* and *B* has a subsidiary *C*, *C* will be regarded a subsidiary of *A*. If Company *D* is a subsidiary of Company *C*, Company *D* will be a subsidiary of Company *B* and consequently also of Company *A*.

(4) A holding company and its subsidiaries are separate companies, each being a distinct legal entity. The holding company need not intervene in a suit filed by a subsidiary company against another subsidiary company. *Turner Morrison & Co.* v. *Hungerford Investment Trust Ltd.*[1]

DIFFERENCES BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

The main points of difference between the two types of companies are enumerated below.

1. *Number of members* : The number of members in a private company cannot be less than two and cannot be more than fifty.

[1] AIR (1969) Cal. 238.

In a public company, the number of members cannot be less than seven but no maximum has been fixed. There may be any number of members.

2. *Restrictions on transfer of shares* : In a private company there must be regulations restricting the transfer of shares. In a public company there need not be any. By restricting transfer, a private company can prevent the membership of persons or classes of persons who are considered to be undesirable.—Sec. 3(1)(iii)(a).

3. *Restriction on invitation to public* : A private company cannot invite the public to purchase its shares or debentures. A public company may do so.—Sec. 3(1)(iii)(c).

4. *Restriction on name* : A private company must add the words, "Private Limited" at the end of its name.—Sec. 13.

5. *Prospectus* : A private company need not file a prospectus or a statement in lieu of prospectus.—Sec. 70(3).

6. *Issue of rights shares* : When a public company proposes to increase its subscribed capital by the issue of new shares, it must be offered first to the existing equity shareholders *pro rata*, unless the members in a general meeting decide otherwise. This provision does not apply to private companies.—Sec. 81(3).

7. *Commencement of business* : A private company can commence business immediately on incorporation, whereas a public company has to wait until it obtains a certificate for the Commencement of Business.—Sec. 149(7).

8. *Statutory Meeting and Statutory Report* : A private company need not hold the Statutory Meeting or file the Statutory Report.—Sec. 165(10).

9. *Managerial Remuneration* : In the case of public companies there are certain limits to managerial remuneration. This rule does not apply to a private company which is not a subsidiary of a public company.—Sec. 189.

10. *Number of directors* : The Act provides that a private company must have at least 2 directors and a public company at least 3 directors.—Sec. 232.

11. *Rules regarding directors* : The rules regarding directors are less stringent in the case of private companies which are not subsidiaries of public companies. Following examples are given :

It is not necessary to file with the Registrar the consent of a director to act as such; amendment of articles regarding appointment of whole-time or non-rotational directors do not require the previous sanction of the Government; provisions regarding the share qualifications of directors laid down in Sections 270-272, do not apply; a private company may provide additional grounds for disqualification of directors and their vacation from office; private companies can give loans to directors; directors of a private company may participate in the discussions of the Board of Directors where contracts in which they are personally interested are being dealt with; the restrictions regarding the appointment of managing directors laid down in Sections 316 and 317 do not apply to private companies; etc.

12. *Company's own share*: In a private company any person can get financial assistance for purchasing the company's own share.

13. *Procedure of meeting*: The law relating to the procedure of Meeting is relaxed in a private company.

14. *Appeal against transfer*: Under certain circumstances, shareholders have no right to appeal against the Board of Directors, if it refuses to register their transfer of shares.

15. *Memo of Contract*: In the case of a public company, if an agent enters into an agreement in which the company is the undisclosed principal, he must make a memorandum of the contract and keep it with the company, otherwise the agreement is not binding on the company. The rule is not applicable to a private company, unless it is a subsidiary of a public company.—Sec. 416.

Privileges of private companies

The main privileges given to private companies, under the Companies Act of 1956, are enumerated in paras 5—15 stated above.

PRIVATE COMPANY INTO A PUBLIC COMPANY

Conversion

A private company can be converted into a public company by procedure stated as follows :

I. By resolution

Section 44 provides the method by which a private company *can be converted* into a public company, *viz.*,

(*a*) by passing a special resolution altering its articles so as to eliminate the three restrictions on private companies (*viz.*, limitation of the number of members to 50; restrictions on the transfer of shares; prohibition of invitation to the public to buy shares or debentures), and

(*b*) filing with the Registrar, within 50 days, a prospectus or statement in lieu of prospectus.

II. By default

A private company may become a public company *by default*, as provided in Section 43.

If a private company fails to comply with the essential requirements of a private company (*viz.*, restrictions on transfer of shares; limitation of the number of members to 50; and, prohibition of invitation to the public to buy shares or debenture) it shall cease to enjoy the privileges of private companies and the company will be treated as if it were a public company.—Sec. 43.

The court may relieve the company from the consequences of non-compliance of the aforesaid restrictions, if it is of opinion that the non-compliance was accidental or was due to inadvertence.

III. By Creating a Statutory Public Company

Where not less than 25% of the paid-up share capital of a private company (having a share capital) is *held by* one or more *bodies corporate*, the private company shall become a public company on and from the date on which the aforesaid percentage is first held.—Sec. 43A. A company of this type has been called, "Statutory Public Company" or "Companies deemed to be public."

The following further provisions of Section 43A are to be noted.

1. *Privileges*: Even after a private company has become a public company by virtue of Sec. 43A, its articles of association may continue to have the three restrictions characteristic of

private companies (*viz.*, limitation of members to 50, restrictions on the transfer of shares and prohibition of invitation to the public to buy shares). The number of members of such a 'public' company may also be reduced to below 7. It may continue to have only two directors.

2. *Computation* : In computing the aforesaid percentage, no account shall be taken of the shares of the company held by a Banking Company on trust or as executors, etc.

3. *Notice* : A private company must inform the Registrar within 3 months of its becoming a public company under this section. The Registrar shall delete the word 'private' from the name of the company and shall also make the necessary alterations in the Certificate of Incorporation and the Memorandum of Association of the company.

4. *Approval* : A private company becoming a public company under this section shall continue as such until it has, with the approval of the Regional Director of the Company Law Board and in accordance with the provisions of the Act, again become a private company.

5. *Exceptions* : Section 43A does not apply to the following cases :

(*a*) to a private company of which the entire paid-up share capital is held by another single private company or by one or more bodies corporate incorporated outside India ; or,

(*b*) to any other private company which satisfies *all* the following conditions, *viz.*, (*i*) the shareholding companies are all private companies, (*ii*) no share of a shareholding company is held by a body corporate, and (*iii*) the total number of shareholders of the shareholding company or the number of shareholding companies together with the individual shareholders does not exceed fifty ; or,

(*c*) to a private company in which shares are held by one or more bodies corporate incorporated outside India which (or each of which) if incorporated in India, would be a private company. In this case an order of the Central Government is necessary. This exception was added in 1965.

IV. Automatic Conversion

Where the average annual turnover of a private company, whether in existence at the commencement of the Companies (Amendment) Act, 1974, or incorporated thereafter, is not, during

the relevant period, less than rupees one crore, the private company shall, irrespective of its paid-up share capital, become, on and from the expiry of a period of three months from the last day of the relevant period during which the private company had the said average annual turnover, a public company by virtue of this subsection.—43A(1A), Companies (Amendment) Act, 1974.

Section 43A of the Companies Act has also been amended in 1988. Previously, a private Company whose average annual turnover was not less than rupees one crore was considered a public company. In sub-Section (1A) for the words "less than rupees one crore", the words "less than such amount as may be prescribed" shall be substituted.

After the commencement of the Companies (Amendment) Act, 1988 a private company accepting deposits from the public will become a Public Company and thereupon all the provisions of this section shall apply thereto.

The following points are to be noted :

1. The above provisions were enforced from 1st February, 1975.

2. A private company which was converted to a public company (under the above rules) may be or may at any time be, reduced to below seven.

3. "Relevant period" means a period of three consecutive financial years—

(*i*) immediately preceding the commencement of the Companies (Amendment) Act, 1974 or

(*ii*) a part of which immediately preceded such commencement and the other part of which immediately followed such commencement, or

(*iii*) immediately following such commencement or at any thereafter.

4. "Turnover", of a company means the aggregate value of the realisation made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.

PUBLIC COMPANY INTO A PRIVATE COMPANY

Conversion

If a Public Company wants to convert itself into a Priv[redacted] Company, it must adopt the following procedure.

1. There must be a Special Resolution altering the articles which (*a*) restricts the right of the members to transfer their shares, if any ; (*b*) limits the number of its members (not counting its employees) to 50 ; (*c*) prohibits any invitation to the public to subscribe for any shares in, or debentures of the company.—Sec. 31(1).

2. After the resolution is passed by the company, it must be approved by the Central Government.

3. The company must file a printed copy of the articles as altered, to the Registrar, within one month of the approval of the Central Government.—Sec. 31(2A).

4. Confirmation by the Court is not necessary.

RESULTS OF CONVERSION

1. A private company loses its privileges when a private company becomes a public company by the methods stated above.

2. The conversion of a public company into a private company, and *vice-versa*, does not change the incorporation of the company.

It also does not affect the legality of the old company or its legal personality of the company. *Hindustan Lever Ltd.* v. *Bombay Soda Factory.*[1]

3. Sec. 43A of the Companies Amendment Act, 1960, has created a mixture between a private company and a public company. A private company, formed by holding bodies corporate (see under III, p. 723) is private in name only but it is actually public. A company of this type has been called, "Statutory Public Company" or "Companies deemed to be Public".

4. The amendment of Companies Act in 1974 also created a mixture between private company and a public company. If a private company has a turnover of Rs. one crore or more, it will be deemed to be a public company. Even under a mixed company, the Government has the power to change the composition of the board of directors, fix the remuneration of the directors, give directions regarding the activity of the companies etc.

FALLING BELOW THE MINIMUM MEMBERSHIP

If the number of members of a public company is reduced to below 7 and that of a private company to below 2 and the

[1] AIR (1964) Mys. 173

company carries on business for more than six months while the number is so reduced, every person who remains a member after six months and is aware of the fact of shortage of members, shall be *personally liable* for all the debts of the company contracted during that time.—Sec. 45.

The company can also be wound up by order of court.

Examples :

(1) In a public limited company there were seven members. The shares of one member were sold by Court auction and were purchased by another member of the same company. The minimum number of membership is reduced to six.

(2) A private company was formed with two persons, the father and his son. The son was the only heir of the father. The father died and all his shares devolved to his son. The minimum number of membership is reduced to one.

COMPANY AND AN ILLEGAL ASSOCIATION

An association of more than 10 persons carrying on business in banking or an association of more than 20 persons carrying on any other type of business must be registered under the Companies Act. If it is not so registered it is deemed to be an illegal association. Such an association suffers from many disabilities. (*i*) It has no legal existence. (*ii*) It cannot enter into contracts. (*iii*) It cannot sue its members or outsiders for money. (*iv*) Every member of such an association is personally responsible for all debts incurred by the association. (*v*) Each such member is liable to be prosecuted in the criminal courts and fined up to Rs. 1,000.

The effect of the aforesaid provisions (which are contained in Sec. 11 of the Companies Act) is to make illegal, a partnership business consisting of more than 10 partners is the case of banking companies and more than 20 partners in other cases. But these rules do not apply to the case of a Joint Hindu Family Firm.

The Act contains provisions for the winding up of unregistered associations.

Classification on the Basis of Ownership :

In accordance with the basis of ownership, a company may be classified into :

(1) government company, (2) non-government company.

GOVERNMENT COMPANY

Definition

A Government Company is one in which not less than 51% of the paid up share capital is held by the Central Government and/or any State Government or Governments or by any two or more of them together. The subsidiary of such a company is also a Government Company.—Sec. 617.

Rules regarding Government Companies

The Act of 1956 contains the following rules regarding Government Companies ;

1. Auditors of Government Companies are to be appointed by the Central Government on the advice of the Comptroller and Auditor General of India.—Sec. 619(2).

2. The Comptroller and Auditor General can direct the manner in which the Company's accounts shall be audited. He can conduct a supplementary test audit of the Company's accounts by officers appointed by him. The auditor must submit a copy of the audit report to him and his comments thereon are to be placed before the annual general meeting of the Company.—Sec. 619(3) to (5).

3. Where the Central Government is a member of a Government company, an annual report on its working and affairs (together with the audit reports and comments thereon) must be submitted to the Parliament. Where any State Government is a member of a Government Company, such documents must also be placed before the State legislature or legislatures.—Sec. 619A.

4. The Central Government may by notification, direct that any of the provisions of the Companies Act shall not apply to any Government Company or apply (other than the provisions noted under 1 to 3 above) with such exceptions, modifications and adaptations as may be specified in the notification.—Sec. 620(1).

A copy of every notification, proposed to be issued, must be laid in draft before both Houses of Parliament for a total period of thirty days which may be comprised in one session or in two or more successive sessions and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, either House disapproves of the issue of the

notification, it shall not be issued. If either House approves the issue of the notification subject only to modifications, it shall be issued only with such modifications as may be agreed upon by both the Houses.—Sec. 620(2).

5. Section 619(2) of the Companies (Amendment) Act, 1974, provides that Sec. 224(1B) and (1C) shall apply to the appointment and re-appointment of auditors.

6. The provisions of section 619 shall apply to a company in which not less than fifty-one per cent of the paid-up share capital is held by one or more of the following or any combination thereof, as if it were a Government company, namely—

(*a*) the Central Government and one or more Government companies ;

(*b*) any State Government or Governments and one or more Government companies ;

(*c*) the Central Government, one or more State Governments and one or more Government companies :

(*d*) the Central Government and one or more corporations owned or controlled by the Central Government ;

(*e*) the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government :

(*f*) one or more corporations owned or controlled by the Central Government or the State Government :

(*g*) more than one Government company.—Sec. 619B, Companies (Amendment) Act, 1974.

7. On 7th June, 1976 it was notified that a Government company can hold vacant land in excess of statutory ceiling.

Case Law :

(1) *Application* : A Government Company may in proper cases be wound up. A scheme about it may also be sanctioned by the court. But a company cannot at once be a Government Company and also a Foreign Company within the Companies Act. *In re River Steam Navigation Co. Ltd.*[1]

(2) *Juristic personality of government company* : A company registered under the Companies Act has a legal entity of its own separate from that of its shareholders, whoever they may be *e.g.*, the Central Government and/or the State Governments, and their nominees. *State*

[1] 71 C.W.N. 854

Trading Corporation v. *Commercial Tax Officer*.[1] The Company and the shareholders are distinct entities. This fact does not make the company an agent either of the President or the Central Government. *Heavy Engineering Mazdoor Union* v. *State of Bihar*.[2] Government companies registered under the Act are non-statutory companies and have a juristic personality of their own like any other company registered under the Act or any other previous companies Act. *Praga Tools Corporation* v. *C. V. Imanual*.[3]

(3) *Position of employee* : A Government company is not identified with the State and its employees are not holders of civil posts under the State. *Ranjit Kumar Chatterjee* v. *Union of India*.[4]

(4) *Orders by the Government* : Certain directives were issued by the President of India from time to time, with regard to the conduct of the business of the Company's Directors. The Directors are bound to give immediate effect to the directives so issued. *Fertilizer Corpn. of India* v. *The Workmen*.[5]

FOREIGN COMPANIES

Definition

Companies falling under the following two classes are called Foreign Companies.—Sec. 591. :

(*a*) Companies incorporated outside India which, after the commencement of the Act of 1956, established a place of business within India.

(*b*) Companies incorporated outside India which have, before the commencement of the Act of 1956, established a place of business within India and continue to have the same at the commencement of the Act.

Rules regarding Foreign Companies

The Companies Act contains the following provisions regarding Foreign Companies.

1. Documents

A foreign company shall within 30 days of the establishment of a place of business in India, deliver to the Registrar for registration—a certified copy of its memo, articles, charter and/or statutes by which it is incorporated ; particulars regarding its Directors and Secretary ; addresses of its registered office and

[1] AIR (1963) Supreme Court 1811 [2] AIR (1970) Supreme Court 82
[3] AIR (1969) Supreme Court 1306 [4] AIR (1969) Cal. 95
[5] AIR (1970) Supreme Court 867

principal place of business ; and name and address of person or persons resident in India authorised to accept service of notices and processes on behalf of the company.—Sec. 592.

Alterations in any of the documents or particulars mentioned above must be immediately notified to the Registrar.—Sec. 593.

2. Accounts

A foreign company must prepare a balance sheet and profit and loss account in the same manner as companies under the Act of 1956 and submit three copies of the same to the Registrar. The Central Government may modify or cancel the application of this rule for any company.—Sec. 594.

3. Name

The name of a foreign company together with the name of the country where it is incorporated, must be conspicuously exhibited (on the outside of every office or plaee where it carries on business in India) in English and in one of the local languages.—Sec. 595(b).

Its name and the name of the country where it is incorporated must also be stated in English in all business letters, bill heads and letter paper and in all notices and other official publications of the company.—Sec. 595(c).

If the liability of the members of the company is limited, the fact must be stated in English and one of the local languages, on the outside of every office or place where it carries on business in India, and on its letter paper, bill heads etc.—Sec. 595(d).

4. Registers etc.

Provisions of the Act relating to registration of charges, appointment of receivers and the keeping of registers, documents and books of accounts, apply to foreign companies.—Sec. 600.

5. Prospectus

A prospectus inviting subscriptions for shares or debentures issued by a foreign company must state the following particulars—name of the Company in English ; name of the country in which it is incorporated ; whether the liability of the members is limited ; particulars regarding its constitution, date of incorporation, addresses of its registered office and principal place of business ; and matters required to be included in a

prospectus issued by an Indian Company. Before it is issued, the prospectus must be registered with the Registrar. If there are untrue statements in the prospectus, the persons responsible for its issue are liable to the same extent and in the same manner as in the case of Indian Companies.—Sections 595(a), 603-8.

6. If one or more citizens of India (or by one or more bodies corporated incorporated in India) whether singly or together of them, hold not less than 50% of the paid up share capital (whether equity or preference or of them together) of a company incorporated outside India and having an established place of business in India such company shall comply with the provision of the Act as if it were a company incorporated in India.—Sec. 591, Companies (Amendment) Act, 1974.

7. On and from the commencement of Companies (Amendment) Act, 1974, the provisions of the following subjects apply to foreign companies, so far as possible—Annual Return (Sec. 159), Books of Accounts (Sec. 209, 209A), Special Audit (Sec. 233 A and B) and the power of the Registrar to call for information. (Secs. 234 to 246).—Sec. 600.

8. Penalties

If the rules mentioned above are not complied with, the company and every officer or agent of the company who is in default may be punished.—Sec. 598.

9. Winding up

Where a body corporate incorporated outside India, which has been carrying on business in India, ceases to carry on business in India it may be wound up as unregistered company according to the provisions of Part X of the Act. (Sec. Ch. 11). A foreign company's business in India can be wound up even in cases where it has been dissolved or ceases to exist by virtue of the laws of the country where it was incorporated.—Sec. 584.

JURISDICTION OF COURTS

Suits relating to the constitution of a company and its winding up are ordinarily dealt with in the High Court of the area in which the registered office of the company is situated. But the Central Government may, by notification, confer power on a District Court to try certain matters relating to companies.—Sec. 10.

Suits of other types (*e.g.*, money suits) by or against the company, may be tried by all Courts. Which court will try the suit is determined by the rules regarding jurisdiction of courts as laid down in the Civil Procedure Code.

COMPANY LAW BOARD

The Company Law Board is a Board, appointed by the Central Government with not more than nine members. It exercises certain functions relating to Company Law, delegated to it by the Central Government. There are four regional directors of the Company Law Board stationed at Mumbai, Kolkata, Kanpur and Chennai. Certain powers of the Board have been delegated to them.—Sec. 10E.

Under the Companies (Amendment) Act of 1974, the Board was empowered to form two more Benches (among the members), exercising the Board's power. Every Bench has powers which are vested under a court under the Code of Civil Procedure, namely, discovery, attendance witnesses production of document etc.

The Company Law Board has been vested with some powers. The important powers are enumerated below :

1. Alteration of memorandum *e.g.*, change of the Object Clause and the change of registered office from one state to another—Sections 17, 18 and 19. (See p. 572).
2. Sanction for issue of shares at a discount.—Sec. 79.
3. Rectification of register of charges.—Sec. 141.
4. Calling extraordinary general meeting.—Sec. 186.

Section 10E of the principal Act has been amended and the amending provision states that the Company Law Board shall exercise and discharge such power and functions as may be conferred on it by this Act of 1988.

The Company Law Board shall in the exercise of its power under this Act, shall be guided by the principles of natural justice and shall act in its discretion.

Subject to the provision of this section the Company Law Board shall have power to regulate its own procedure.

Section 10F of the Company Act has been amended and the amending provision states that any person aggrieved by any decision or order of the Company Law Board may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Company Law Board relating to any question of law emerging from such order.

ADVISORY COMMITTEE

For the purpose of advising the Central Government and the Company Law Board on such matters arising out of the administration of the Companies Act as may be referred to it by the Government or Board, the Central Government may constitute an Advisory Committee consisting of not more than five persons, with suitable qualifications,—Sec. 410, as amended in 1965. Formerly this body was known as the Advisory Commission.

EXERCISES

1. An incorporated company is a "totally different person or thing or entity from its members—the individuals comprising it." Explain and illustrate. (Pages 540-542)
2. Distinguish between the following :
   (1) Partnership and a Company. (Pages 543-544)
   (2) A Public Company and a Private Company. (Page 549
   (3) A Holding Company and a Subsidiary Company. (Page 548)
   (4) Company and Illegal Association. (Page 556)
   (5) Registered Company and Unregistered Company. (Page 540)
3. Write notes on the following : Statutory Company ; Chartered Company ; Body Corporate ; Existing Company ; Group ; Public Financial Institution ; Advisory Committee. (Pages 539 ; 540 ; 546 ; 547 ; 563)
4. State the rules relating to conversion of a private company into a public company and *vice versa*. (Pages 551-555)
5. State the procedure for the conversion of a public company into a private company. (Pages 554-555)
6. State the circumstances in which a Private Company will automatically become a Public Company. (Pages 553-554)
7. What is the effect of the failure by a private company to observe the limitations and restrictions placed upon it by the Companies Act ? (Pages 554-555)
8. What is the liability of the member of a private company which continues to do business where the number of member is reduced to, below two ? (Page 555)
9. Comment on : A company is a legal person and it has identity separate from members comprising it. (Page 538)
10. Define a "Government Company". State the rules of the Company Act relating to Government Companies. (Page 557)
11. What are the provisions relating to Foreign Companies in India ?
12. Point out the difference between a private company and a public company. (Page 549)

13. Objective Questions.
    (*a*) When all members have unlimited liabilities in a limited company ? (Page 556)
    (*b*) What is illegal association ? (Page 556)
    (*c*) What is meant by a company ? (Page 558)
14. *Problem* : A public limited company has only seven shareholders. All the shares are fully paid up. The shares of one of the shareholders were sold in a court auction and were purchased by another shareholder of the company to the knowledge of all the other shareholders. The company continued to carry on the business thereafter. What are the legal consequences of this transaction ? (Page 556)

2 THE MEMORANDUM AND ARTICLES OF ASSOCIATION

DEFINITIONS AND DIFFERENCES

Definition of Memo

The Memorandum of Association is a document which contains the fundamental rules regarding the constitution and activities of a company. It is the basic document which lays down how the company is to be constituted and what work it shall undertake. The purpose of the memorandum is to enable the members of the company, its creditors, and the public to know what its powers are and what is the range of its activities. The memorandum contains rules regarding the capital structure, the liability of the members, the objects of the company, and all other important matters relating to the company. The memorandum is altered only after certain formalities are observed.

The Importance of the Memo

The Memorandum shows the range of the enterprise. The memorandum is the foundation on which the superstructure of the company has been built up. It enables the shareholders, creditors and outsiders to show the permitted activities of the company. *Egyptian Salt and Soda Co. Ltd.* v. *Port Salid Salt Association Ltd.*[1] (See p. 574 and p. 580).

Definition of Articles

The Articles of Association is a document which contains rules, regulations and bye-laws regarding the internal management of the company. Articles must not violate any provision of the memorandum or any provision of the Companies Act. The rules laid down in the articles must always be read subject to the rules contained in the memorandum.

Relationship

Lord Cairns in *Ashbury Railway Carriage & Iron Co.* v. *Riche*,[2] described the relationship between the memorandum and the articles in this language : "The memorandum is as it were,

[1] (1931) A.C. 677

[2] (1875) 7 H. L. 653

the area beyond which the actions of the company cannot go ; inside the area, the shareholders may make such regulations for their own government as they think fit."

1. The Articles are subordinate to Memorandum.

2. The Memorandum must be read in conjunction with the Articles.

3. The terms of the Memorandum cannot be modified or controlled by the Articles.

Public Documents

The Memo and Articles are *public documents*, which may be inspected by anybody at the office of the Registrar of Companies. Any person dealing with a company is presumed to have constructive notice of their contents. The members of a company are entitled to have copies of the memo and the articles, on payment of a small fee.

Differences

The distinction between the memorandum and the articles of association can be summed up as follows :

1. The memorandum is the fundamental charter of the company determining its constitution and objectives ; the articles are rules regarding internal management.

2. Any rule in the articles contrary to the memorandum is invalid.

3. Articles can be altered easily, the memorandum can be altered only after the adoption of certain formalities.

4. Certain clauses of memo cannot be altered without the sanction of the Central Government and of the Court e.g., the object clause and the liability clause. Other clauses can be altered easily e.g., the name clause. Articles can be altered by passing a special resolution. The approval of the Central Government is required in special cases *e.g.*, the remuneration of directors of public companies. For change of articles, Court sanction is generally not required.

5. The memo defines the powers of the company and the relationship between the company and the members and also non-members. Articles define and regulate the relationship between the company and the members and the relationship between the members *inter se*.

6. Acts beyond the powers of memo (*ultra vires*) are void. Such an act cannot be ratified by the members even by a unanimous resolution. But acts done by a company beyond the articles can be ratified by the shareholders provided they are within (*intra vires*) the powers of Memo.

7. If an act is within the powers given by the memo (*intra vires* the memo) but contrary to some provision of the articles (*ultra vires* the articles) the members can change the articles and ratify the act.

THE FORM AND CONTENTS OF THE MEMORANDUM

Section 13 : The Act lays down that the memorandum of a association of every company shall contain the following particulars :

1. Name Clause

The name of the company with the word "limited" at the end of the name of a public company and the words "private limited" at the end of the name of a private company.

2. Situation Clause

The name of the State in which the registered office of the company is to be situated.

3. Objects Clause

The objects of the company. The Companies (Amendment) Act, 1956, provides that in the case of a company formed after the said amending Act, the Memo must state separately (*i*) the main objects and objects incidental and ancillary to the main objects, and (*ii*) other objects not included in (*i*).

4. Area of Operation Clause

Except in the case of trading corporations, the State or States to whose territories the objects extend.

5. Liability Clause

The nature of the liability of the members, *i.e.*, whether limited by shares or by guarantee or unlimited.

6. Capital Clause

In the case of a company having share capital—unless the company is an unlimited company, the memorandum shall state

the amount of share capital and the division thereof into shares of a fixed amount.

7. The Association and Subscription Clause

No subscriber to the memorandum shall take less than one share ; and each subscriber to the memorandum shall write opposite to his name the number of shares he takes.

Section 14 : The Act lays down that the memorandum shall be according to the prescribed form or as near to it as circumstances admit. The memo must be drafted, as described, to suit the needs of the company concerned, but the particulars mentioned above must be included, and, there must be nothing contrary to the provisions of the Act.

In Schedule I to the Act four model forms are given. They relate to the following four types of companies :

Table B. Company Limited by Shares.
" C. " " Guarantee and not having a share-capital.
" D. " " Guarantee and having a share-capital
" E. Unlimited Company.

Section 15 : The Act provides that the memorandum must be printed ; divided into paragraphs numbered consecutively ; and signed by each subscribed (who shall add address, description and occupation, if any). The signature of the subscriber shall be attested by at least one witness who shall likewise add his address, description and occupation, if any. In the case of public companies the Memo must be signed by at least 7 persons ; in the case of private companies by at least 2 persons.

RULES REGARDING THE NAME OF COMPANY

A company cannot adopt a name by which another company is registered. If by inadvertence, mistake or otherwise, a name is selected which is the same as that of an existing company or closely resembles it, the name must be changed.

If the name of company closely resembles the name of a previous company, the public may be misled and may be defrauded. In such a case the Court will direct the change of the name of the company. *Tussaud & Sons* v. *Tussaud.*[1]

[1] (1890) 44 Ch. D. 673

A company cannot use a name which is considered undesirable by the Central Government (Sec. 20). Under the Emblems and Names (Prevention of Improper Use) Act of 1950 the Government has power to declare what names and emblems are not to be used by companies and in trade marks and patents. The use of the following has been prohibited under the above Act—name and emblems of the U.N.O and W.H.O.; the Indian National Flag; the official seal and emblems of the Central Government and the State Governments; name and pictorial representations of Mahatma Gandhi and the Prime Minister of India; the 'Interpol'. The Central Government can declare any other name as undesirable and prohibit the use of the same by a company.

Subject to the above rules, a company can adopt any name it likes.

The name and the address of the registered office of every company must be painted or affixed on the outside of its business premises in a conspicuous position and in letters easily legible in one or more of the language used in the locality (Sec. 147). The words "Limited" and "Private Limited" are parts of the names of public and private companies respectively and must be added at the end of the name of the company.

The name and the address of the registered office of the company must be engraven in legible characters on the company's seal and mentioned in all business letters, bill heads, notices and other documents (Sec. 147). But they need not be mentioned in advertisements. Failure to publish the name and the address of the registered office in the manner laid down in Section 147, is punishable with a fine.

[Procedure for changing the name—See below under "Alteration of Memorandum".]

Non-Profit Association See pp. 544-545.

RULES REGARDING THE REGISTERED OFFICE

A company shall from the day on which it commence business or within 30 days after incorporation, whichever is earlier, have a registered office to which all communications and notices may be addressed. Notice of the situation of the registered office, and of every change therein, shall be given within 30 days

after the date of the incorporation of the company or after the date of the change, as the case may be, to the Registrar who shall record the same.—Sec. 146.

If the situation of the registered office is changed from one place to another within the same town or village, no amendment of the Memo is required but notice must be given to the Registrar.

If the registered office is changed from one city, town, or village to another (within the same State) a special resolution must be passed, and notice must be given to the Registrar.

Failure to comply with the above rules may be punished with fine which may extend to Rs. 50 for every day during which the offence continues.

To change the registered office from one State to another, it is necessary to amend the Memorandum. (See below, under "Alteration of Memorandum".)

FORM AND CONTENTS OF THE ARTICLES

Rules

The Articles of Association contain rules, regulations and bye-laws regarding the internal management of companies. An unlimited company, a company limited by guarantee and a private company limited by shares must file their articles of association at the time of registration of the company.—Sec. 26.

A public company may or may not file articles. If it does not, the regulations contained in Table A will apply to it. (Table A is a set of model articles printed in Schedule I to the Companies Act).

The articles of a private company must contain the restrictive features peculiar to private companies (*viz.*, limitation of the number of members to 50 ; restrictions on the transfer of shares ; prohibition of invitation to the public for the purchase of shares and debentures). —Sec. 27 (3).

In the case of a company limited by guarantee, the articles shall state the number of members with which the company is to be registered.—Sec. 27(2).

In the case of an unlimited company, the articles shall state the number of members with which the company is to be registered and, if the company has a share capital, the amount of such share capital.—Sec. 27(1).

Form of Articles

Model forms of articles, for use in the case of companies not limited by shares, are given in Schedule I to the Act.

The Articles shall :

(*a*) be printed ;

(*b*) be divided into paragraphs numbered consecutively ; and

(*c*) be signed by each subscriber of the memorandum of association (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.—Sec. 30.

Contents of Articles

Articles usually contain provisions in respect of the following matters : (1) share capital, rights of shareholders, payment of commissions, share certificates ; (2) lien on shares ; (3) calls on shares ; (4) transfer of shares ; (5) transmission of shares ; (6) forfeiture of shares ; (7) conversion of shares into stock ; (8) share warrants ; (9) alteration of capital ; (10) general meetings and voting rights of members ; (11) appointment and remuneration of directors, board of directors, managers and secretary ; (12) dividends and reserves ; (13) accounts and audit and borrowing powers ; (14) capitalisation of profits ; and (15) winding up.

Interpretation

The Articles of Association are commercial documents and they should not be interpreted very strictly. *Re Hartley Baird Ltd.*[1] The Articles should be construed so as to give the company a reasonable business efficacy and make them workable. *Holmes* v. *Keyes.*[2]

Companies which must possess their own Articles. The following companies must have their own articles, namely,

(*a*) unlimited companies, (*b*) companies limited by guarantee, (*c*) private companies limited by shares.

ALTERATION OF THE MEMORANDUM

The Memorandum of Association of a company can be altered by following the procedure laid down in the Companies Act. The procedure is different for different clauses of the memo.

[1] (1955) Ch. 143. [2] (1958) 2 W.L.R. 772.

For the purpose of alteration, the provisions of the memo can be divided into two classes : (*i*) provisions the inclusion of which is made compulsory by the Act (*e.g.*, the name, objects, place of registered office etc.) (*ii*) other provisions which the organisers of the company have thought it desirable to include.

Provisions coming under the second category can be altered in the same way as provisions of the Articles of Association, (*i.e.*, by special resolution) unless otherwise provided in the Act.

Provisions coming under the first category are called "Conditions contained in the Memorandum". The "conditions" can be altered in the manner stated below :

1. Change of name

A company may change its name by special resolution provided the Company Law Board approves of the change.—Sec. 21. No such approval is necessary in cases of addition or deletion of the word "Private", when a Public Company is converted into a private Company and *vice-versa*.

If by inadvertence a company is registered with a name which is identical with or closely resembles the name of an existing company the name may be changed by an ordinary resolution, with the previous approval of the Company Law Board. If the company takes no steps in the matter, the Board may direct it to change its name within a prescribed period.—Sec. 22.

When the name is validly changed, the Registrar shall enter the new name in the Register of companies and shall issue a fresh Certificate of Incorporation. The Registrar shall also make the necessary alteration in the memorandum of association of the company.—Sec. 23(1) and (2).

Change of name does not affect the rights and obligations of the company and pending suits by or against the company.—Sec. 23(3).

2. Change of Object

(Sections 17-19). The object clause of the memo can be changed for the purpose of enabling the company :

(*a*) to carry on its business more economically or more efficiently ;

(*b*) to attain its main purpose by new or improved means ;

(*c*) to enlarge or change the local area of its operation ;

(*d*) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the objects specified in the memorandum ;

(*e*) to restrict or abandon any of the objects specified in the memorandum ;

(*f*) to sell or dispose of the whole, or any part of the undertaking, of the company ; or

(*g*) to amalgamate with any other company or body of persons.

The following procedure must be adopted for changing the object clause :

(*i*) A special resolution must be passed.

(*ii*) A petition must be filed to the Company Law Board for confirmation of the change.

(*iii*) Notice must be given to all persons whose interests will be affected by the change (unless the Board otherwise directs).

(*iv*) The consent of the creditors of the Company must be obtained or other claims paid off or secured.

(*v*) Notice must be given to Registrar of Companies, so that he can appear before the Board and state his objections and suggestions, if any.

(*vi*) After the Board has confirmed the alterations, a certified copy of the Board's Order, together with a printed copy of the Memo as altered shall be filed with the Registrar within 3 months of the date of the order.

The certificate of the Registrar of Companies is conclusive evidence of the alteration and its validity.—Sec. 18.

When the alteration is given effect to. The alteration takes effect after it is registered. If no registration is made within 3 months (or such further time as may be allowed by the Board) the alteration and the entire proceedings connected therewith become void. The Board, may, on sufficient cause shown, revive the order of alteration on an application made within one month.

Powers of the Company Law Board

Formerly the Court dealt with all cases regarding sections 17, 18 and 19 of the Companies Act. After the amendment of this Act in 1974, they are decided by the Company Law Board.

The Board has a wide discretion in allowing changes in the objects clause. The Board must take into consideration the rights

and interests of the members of the Company and those of its creditors. The Board may allow the change partially or wholly, or may disallow the change. The Board may adjourn the proceedings in order that the Company may purchase the interests of the dissentient members. Orders may be passed for facilitating such arrangements (but no part of the capital of the Company can be spent in any such purchase).

In several Court cases it has been held that if the proposed changes will radically alter the original objects of the Company, the change will not be allowed. The proposed changes must be for any of the 7 purposes, (*a*) to (*g*), mentioned above.

Examples :

(*i*) The main business of a Company was mining. It applied for permission to alter the object clause of the memo so as to enable it to start hotels and sell goods on hire-purchase. The alteration was not granted. *In re Bharat Mining Corporation Ltd.*[1]

(*ii*) A company was carrying on business in jute and it had power to undertake such business under the objects clause of its memo. In a meeting, the members unanimously passed a special resolution to start business in rubber. The alteration of the object clause was not granted. *In re Bhutoria Bros. (P) Ltd.*[2]

(*iii*) An incorporated Cyclists Club wanted to alter its memorandum so that motorists can become members. The Court refused to allow the alteration because it will change its objects completely. *Re Cyclists Touring Club Ltd.*[3]

(*iv*) But the Court may allow a company to start a completely new kind of business if this can be conveniently or advantageously carried on with its old business, and in general, the company is the best judge to decide whether it would be able to combine new business conveniently. *Re Paremt Tyre Co.*[4]

3. Change in the location of the registered office from one State to another

The procedure to be adopted is the same as in the case of alteration of object. See (*i*) to (*vi*) above ; p. 573.

The alteration must be registered with the Registrar of Companies of the State in which the registered office of the Company was originally situated and also the Registrar of the State to which the office is being transferred. The records of the Company will be transferred to the latter place.

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[1] 71 C.W.N. 359
[2] (1957) Cal 593
[3] (1907) 1 Ch. 269
[4] (1923) 2 Ch. 222

Examples :

(*i*) The transfer of a registered office of a company outside Orissa was opposed by Orissa Government on the ground of loss of revenue and reduction of employment opportunities. It was argued that in a federal constitution every state has the right to protect its revenue. The Court agreed and the transfer was not allowed. *Orient Paper Mills Ltd* v. *The State*.[1]

(*ii*) The transfer of a registered office by itself does not affect, or appreciably affect, the scope of employment of the people of the State. It was therefore useless to refuse to confirm the alteration on the ground of loss of prospect of employment in the State. The High Court sanctioned the resolution allowing transfer of the company's registered office from Calcutta to Bombay. *Rank Film Distributors* v. *The Registrar of Companies*.[2])

4. Alteration of the Capital Clause

Alteration of the capital clause can be done in the following methods (*i*) Alteration, including Increase of Capital (*ii*) Reduction of Capital (*iii*) Variation of Shareholders' Rights and (*iv*) Creation of Reserve Capital. These topics are discussed below.

ALTERATION OF SHARE CAPITAL

Section 94 of the Act provides that a company may, if so authorised by the articles, alter its share capital in any one of the following ways :

(*a*) increase its share capital by such amount as it thinks expedient by issuing new shares ;

(*b*) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares ;

(*c*) convert all or any of its fully paid up shares, into stock, and reconvert stock into fully paid up shares of any denomination ;

(*d*) sub-divide its shares or any of them, into shares of smaller amount than is fixed by the memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived ;

(*e*) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be

[1] AIR (1957) Orissa 232 [2] AIR (1969) Cal. 32

taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Alterations coming within aforesaid categories, can be made by a company by resolution passed in a general meeting. Confirmation by the court is not necessary. Cancellation of shares under this section [item (*e*) above] is not deemed to be a reduction of share capital. Notice of any alteration made under this Section must be given to the Registrar within 30 days of the alteration.

Increase of Capital

Increase of Capital can be done by the issues of new shares, within the limits of the Authorised Capital as registered and as stated in the memo and articles. Such shares are called Rights Shares. For the issue of such shares a special procedure must be adopted. (See ch. 4)

The Company can increase its Registered Share Capital. The procedure of increase is by passing an ordinary resolution. The consent of the Central Government is necessary in certain special cases. Notice of the alteration must be given to the Registrar within 30 days of the date of resolution.

Case Law :

It is not true to say, as a statement of law, that Directors have no power to issue shares at par, if their market price is above par. Such discretionary powers in company administration are in the nature of fiduciary powers and must, for that reason, be exercised in good faith. Mala fides vitiate the exercise of such discretion. *Needle Industries (India) Ltd., and others* v. *Needle Industries Newey (India) Holdings Ltd., and others.*[1]

REDUCTION OF SHARE CAPITAL

Reduction of share-capital may be made for any one or more of the following purposes : (*a*) to extinguish or reduce the liability of the shareholders as regards the uncalled capital ; (*b*) to cancel any paid up share capital which is lost or is unrepresented by available assets ; (*c*) to pay off any paid up share capital which is in excess of the wants of the company ; and (*d*) by any other method approved by the court.

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[1] AIR (1981) Supreme Court 1298

Procedure for reducing Share Capital

A company can reduce its share capital, provided the following requirements are complied with.—Sections 100-105.

1. Reduction of capital must be authorised by the articles. If the existing articles do not give that power, they may be amended.

2. A special resolution must be passed. The resolution for reduction must be just and equitable.

3. Sanction of the court must be obtained.

The Court, may, before giving sanction to the reduction, direct the issue of notices to all creditors of the company whose claims are of such a nature that they are provable upon winding up. The court is to settle the list of creditors for this purpose. After hearing the objections of the creditors, if any, the court may direct that before reduction of capital is allowed, the claims of the creditors must be either paid up or secured. The Court protects the interest of the creditors and of the minority groups of shareholders.

The court may order that for a specified period after the reduction, the company shall add the words "and reduced" at the end of its name.

The court may also order the publication of the reasons which led the company to reduce its capital, so that the public may be informed.

4. A certified copy of the Court's order and a minute approved by the Court showing what has been done, must be filed with the Registrar for registration. The reduction takes effect from the date of registration.

After reduction, the liability of the shareholders becomes as ordered by the court and as recorded in the minute of reduction. But if there is a creditor who was ignorant of the proceedings for reduction and if the company is unable to pay his claim, all shareholders whose liabilities were reduced will be bound to contribute towards the claim of the creditor to the same extent as they would have had to, had there been no reduction.

Officers of the company, who conceal the name of any creditor entitled to object, are punishable with imprisonment up to one year or with fine.

VARIATION OF SHAREHOLDERS' RIGHTS

The rights given by the memorandum and the articles to the different classes of shareholders may be varied if the following requirements are fulfilled.—Sections 106, 107.

1. There must be provision in the memorandum or the articles for such variation, or (in the absence of any such provision in the memorandum or articles) if such variation is not prohibited by the terms of issue of the shares of that class.

2. The variation must be agreed to by the holders of any specified proportion, not less than 3/4th, of the issued shares of that class. Specified means specified in the memo or the articles. The consent may be given by a resolution passed in a meeting of the holders of that class of shareholders or otherwise.

The variation may be challenged in court by an application made by at least 10% of the aggregate number of holders of that class of shares. They must be persons who did not vote for the resolution for variation. The application must be made within 21 days of the resolution or consent. If the court is of opinion that the variation is of such a nature as would unfairly prejudice the rights of that class of shareholders, the court may disallow the variation. The decision of the court is final. The order of the court must be communicated to the Registrar by the company, within 30 days of receiving it.

RESERVE CAPITAL

A limited company may by special resolution determine that any portion of its share capital which has not been called up, shall not be called up, except in the event of the company being would up.—Sec. 99.

The uncalled capital, freed from call in the manner aforesaid, is called the Reserve Capital of the company. The company cannot charge the reserve capital for raising a loan, nor can it be dealt with in any way except on liquidation.

ALTERATION OF THE ARTICLES OF ASSOCIATION

Section 31 of the Act gives to all Companies a statutory right to alter articles and this right cannot be taken away by any provision in the existing articles or the memorandum. A provision, prohibiting change of articles, is not binding on the members.

Although alteration of articles is permitted, there are certain restrictions on the nature and extent of the alterations that can be made.

1. Articles can be altered by special resolution only. If the articles of the company prescribed a different procedure, *e.g.*, an ordinary resolution, it will *not* be followed. Confirmation by the Court is not necessary.

2. No change is permitted which will violate the provisions of the Companies Act.

3. No change is permitted which is contrary to the conditions contained in the Memorandum of Association of the Company.

4. The alterations must not contain anything illegal.

5. The liability of the members or any class of members, cannot be increased without their consent. *Example* : a member cannot, by altering articles, be made to take more shares or to pay more for the shares already taken, unless he agrees to do so in writing either before or after the alteration. But where the company is a club or association, the articles may be validity altered to provide for subscription or charges at a higher rate.—Sec. 38.

6. Alteration of certain provisions of the articles required the previous consent of the Central Government (*viz.*, alteration of articles regarding the number of directors and their remuneration ; etc).

7. An alteration of articles which has the effect of converting a public company into a private company shall not have effect unless the alteration is approved by the Central Government.

8. The alteration must not constitute a fraud on the minority. The majority (or the ruling group) must not by altering the articles affect the interests of the minority. The Courts have been given extensive powers to prevent such misuse of power. (See ch. 10)

9. But any alteration made *bona fide*, in the interests of the Company as a whole, is valid and binding even though the private interests of some members may be affected.

Example :

In a private limited company, the majority of shares were held by the directors. The articles were altered and the directors were given powers to compel members carrying on business in competition with the company to sell their shares (as full value) to a nominee of

the directors. Held, the alteration was valid. *Sidebottom* v. *Kershaw Leese & Co. Ltd.*[1]

10. The Court cannot order rectification of articles, even on the ground of mistake. But the court can declare particular clauses to be *ultra vires Scott.* v. *Frank F. Scott Ltd.*[2]

11. Articles may be altered with retrospective effect. The company was allowed to insert a lien clause conferring upon the company a lien on the shares of members for debts incurred before and after the insertion of this clause. Held, that the company had power to insert this clause which was valid and effective. *Allen* v. *Gold Reefs of West Africa Ltd.*[3]

12. The alteration must not lead a breach of contract with the outsiders.

THE LEGAL EFFECTS OF THE MEMORANDUM

The Contractual Powers of a Company

A Company or a Corporation is an artificial person created by law. It is a legal person capable of suing and of being sued. But the contractual powers of a company are limited in two ways : (*i*) natural possibility and (*ii*) legal possibility.

(*i*) Natural Possibility

The fact that a company is an artificial person leads to the result that a company must always enter into contract through agents.

(*ii*) Legal Possibility

A joint stock company cannot enter into any contract the object of which goes beyond the memorandum of association of the company. A statutory corporation cannot enter into any contract which is beyond the scope of its powers as laid down in the statute by which it was created. (See below).

Forms of Contracts and Deeds of a Company—See ch. 7.

The Doctrine of Ultra Vires

The Memorandum of Association determines the constitution and the powers of the Company. It was observed by Lord Selbourne that the memorandum is the Company's "fundamental

[1] (1920) 1 Ch. 154
[2] (1940) 1 Ch. 794
[3] (1900) 1 Ch. 656

and unalterable law". A Company is incorporated only for the objects and purposes expressed in the memorandum. Any act purported to be done by the Company which is beyond the scope of the functions of the Company as laid down in the memorandum is *ultra vires i.e.*, beyond the powers of the Company, and of no effect.

In *Ashbury Railway Carriage & Iron Co.* v. *Riche*.[1] a company was constituted for the purpose of manufacturing railway wagons. The company purchased the right to run a railway in Belgium. It was held that the purchase was invalid. In this case it was observed that the Memorandum of Association has a twofold effect—an affirmative effect stating what the Company can do and a negative effect indicating what the Company cannot do. "It (the Memo) states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporation life for any other purpose than that which is so specified." It was also observed in the judgment that, "The directors and shareholders, even if they are unanimous, cannot do things which are not authorised by the memorandum."

The important rules concerning the legal effects of the memorandum can be summed up as follows :

1. The terms of the memorandum constitute a binding contract between the Company and the members.—Sec. 36.

2. All acts done by the directors or members beyond the powers given in the memo, are *ultra vires* and not binding on the Company.

3. The members cannot ratify *ultra vires* acts, even by an unanimous resolution.

4. It an act is within the powers given by the memo *(intra vires* the memo) but contrary to some provision of the articles (*ultra vires* the articles) the members can change the articles and ratify the act.

5. The object clause in the memorandum is construed like other documents and the Company may do anything which is fairly incidental to and consequential upon the powers specified. *Attorney-General* v. *Great Eastern Rly.*[2]

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[1] (1857) 7 H.L. 653 [2] (1880) 5 A.C. 473

The following acts have been held to be valid even though there were no provisions about them in the Memo or Articles.— Grants to an University for research, *Evans* v. *Brunner, Mond & Co. Ltd.*[1]; payment to widows of ex-employees, *Handerson* v. *Bank of Australia.*[2] Ex-gratia payments to workers for incentives, *Hempson* v. *Price's Patent Co.*[3]

The Board of directors decided to pay a pension to the widow of the former managing directors of the company. Held, such a payment is not for the benefit of the company, nor can it be called incidental to the business of the company. The payment is *ultra vires*. *Re Lee Behren & Co. Ltd.*[4]

6. If a director makes an *ultra vires* payment (*e.g.*, paying interest out of capital) he can be compelled to refund the money to the Company.

7. Contracts which are *ultra vires* the Company are not binding on the Company. But the aggrieved party can be given relief in certain cases.

Examples :

(*i*) If a Company takes an *ultra vires* loan and uses it to pay off a creditor, the second creditor is substituted in the position of the first creditor and can recover the money. *In re Wrexham Rly. Co.*[5]

(*ii*) If goods are obtained by a Company by an *ultra vires* contract and the goods can be traced in the hands of the Company, the Company can be ordered to return it. *Sinclair* v. *Brougham.*[6]

(*iii*) If money is lent by a Company not having power to lend it, the money can be recovered because the debtor will be estopped from taking the plea that the company laid no power to lend. *Cotman* v. *Brougham.*[7]

8. Directors entering into *ultra vires* contracts may be liable to the third party for breach of warranty of authority.

9. The memorandum is a public document. Every person dealing with a Company is presumed to know the contents of the memo.

LEGAL EFFECT OF THE ARTICLES

Section 36 of the Act provides that, "subject to the provisions of this Act, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent

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[1] (1921) 1 Ch. 359
[2] (1889) 40 Ch. D. 170
[3] (1876) 5 L.J. Ch. 437
[4] (1932) 2 Ch. 46
[5] (1899) 1 Ch. 440
[6] (1914) A.C. 398
[7] (1918) A.C. 514

as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles."

Binding Contract

Thus the articles constitute a binding contract between the company and its members. *Beattie* v. *Beattie. Ltd.*[1]; *Hanuman Prasad* v. *Hiralal.*[2]

A company is bound to the members in the same manner as the members are bound to the company. The Articles constitute a contract between members. But the Articles do not constitute any binding contract as between the company and an outsider.

The provisions of the articles can be enforced by suit by the company and the members.

But if the articles are violated by a member, a suit for the enforcement of the articles can be brought only by the Company and not by other members, unless the person against whom relief is sought, controls the majority of shares and will not allow a suit to be brought in the name of the company. *Burland* v. *Earle.*[3]; *The Dhakeswari Cotton Mills Ltd.* v. *Nilkamal.*[4]

The articles come within the definition of public documents. All persons dealing with the company are presumed to know the provisions of the articles. So if anything is done contrary to or beyond the provisions of the articles, the company is not bound.

Examples :

(*i*) The articles of a company provided that the company will have a first charge on the shares for debts due to the company from the members. A member, owing money to the company, borrowed money from a bank on the security of the shares. Held, the company's claim would have priority because of the provision in the articles, *Bradford Banking Company* v. *Briggs.*[5]

(*ii*) The articles of a company provided that if a member became insolvent, his shares were to be sold to a nominee of the company at a fixed price. Held the provision was binding and the trustee in bankruptcy cannot claim the share. *Borland's Trustee* v. *Steel Bros.*[6]

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[1] (1938) Ch. 708
[2] AIR (1971) Supreme Court 206
[3] (1902) A.C. 83
[4] (1938) 1 Cal 90
[5] (1886) 12 A.C. 29
[6] (1901) 1 Ch. 279

(*iii*) By a special resolution the Company reduced the remuneration of each director, with retrospective effect from the end of the preceding year. Held, the company can vary the terms of the service *as to the further* but it cannot vary the terms adversely with restropective effect. *Swaby* v. *Port Darwin Gold Co.*[1]

THE DOCTRINE OF INDOOR MANAGEMENT

Definition

When the articles of association of a company prescribed a particular procedure for doing a thing, the duty of carrying out the provisions lies on the person in charge of the management of the company. Outsiders are entitled to assume that the rules have been complied with. This is known as the Doctrine of Indoor Management.

Example :

The articles of a company provided that the directors can give a bond if authorised by a resolution of the company. The directors gave a bond to *T* although no resolution was passed. Held, *T* was entitled to assume that the resolution was passed (because it was a matter of internal procedure) and the company was bound by the bond. *Royal British Bank* v. *Turquand*[2]

The Doctrine of indoor management does not apply in certain cases :

(*a*) Void Acts

Where the act is void *ab initio*, the company is not bound, *e.g.*, forgery.

Examples :

(*i*) An act *ultra vires* the memo or articles cannot bind a company.

(*ii*) A Share certificate forged by the secretary of the company and issued under the seal of the company cannot confer any right on the holder thereof. *Ruben* v. *Great Fingall Consolidated*.[3]

(*b*) Knowledge of irregularity

Where the person dealing with the company has notice, actual or constructive, that the prescribed procedure has not been complied with the company is not bound.

Example :

X company lends money to *Y* company on a mortgage of its asset. The procedure laid down in the articles for such transaction was

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[1] (1881) I Meg. 385 [2] (1856) 6 E & B 327

[3] (1906) A.C. 439

not complied with. The directors of the two companies were the same. Here it may be presumed that the lender had notice of the irregularity. Hence the mortgage is not binding. *Pratt Ltd.* v. *Sassoon & Co. Ltd.*[1] *Morris* v. *Kanssen.*[2]

(c) Lack of authority

If an agent of a company makes a contract with a third party and if the act of the agent falls outside the ordinary authority of the agent, the company is not bound. *Houghton & Co.* v. *Nothard, Lowe and Wills.*[3]

Example :

A branch manager of a company drew bills of exchange and also endorsed bills on behalf of the company, although they had no authority for these acts from the company. Held, the company was not bound. *Kreditbank Cassel* v. *Schenkers.*[4]

EXERCISES

1. What is a memorandum of association ? State the contents of the Memorandum. (Pages 565 ; 567-568)
2. State the points of difference between the Memorandum of Association and the Articles of Association of a Limited Company. (Page 566)
3. How can you make an alteration in the Objects Clause of a Memorandum of Association ? (Pages 571-572)
4. Describe the procedure for changing the object clause in the memorandum of association of a company according to the Companies Act, 1974. (Page 572)
5. State how the Memorandum of Association can be altered. When is such alteration given effect to ? (Pages 571-572)
6. What are the restrictions on the name of a company ? State the methods of altering the name of a company. (Page 568)
7. Discuss the power to alter the Articles of a company and its limitations. (Pages 578-580)
8. State how reduction of share capital can be made under the Companies Act. (Pages 576-577)
9. Explain how a share capital of a company can be increased. (Page 575)
10. State and explain the doctrine of Indoor Management. (Page 584)
11. What are the effects of the memorandum and the articles after they are registered ? (Page 578)

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[1] 40 Bom L.R. 978
[2] (1946) 1 A.C. 459
[3] (1927) 1 K.B. 246
[4] (1927) 1 K.B. 826

12. To what extent may a company lawfully undertake business and perform acts not expressly set out in the object clause of the Memorandum of Association ? (Page 571)
13. What is the function of the liability clause in the Memo and its limitation, if any ? (Page 576)
14. Write notes on : (*a*) Articles of Association. (*b*) Doctrine of indoor management : (*c*) Objects Clause ; (*d*) Reserve Capital ; (*e*) Doctrine of Ultra Vires ; (*f*) Reduction of Capital.
[Pages (*a*) 565 ; (*b*) 583 ; (*c*) 566 ; (*d*) 578 ; (*e*) 580 ; (*f*) 576]
15. Write note on the importance of the Objects Clause. (Page 567)
16. Discuss the '*doctrine of ultra vires*' in the Companies Act. (Page 578)
17. Objective questions :
(*a*) What do you understand by Articles of Association ? (Page 565)
(*b*) Write an explanatory note on the doctrine of *ultra vires* in relation to companies. What are the liabilities of a company and its agents for *ultra vires* acts ? (Page 580)
18. *Problem* : (*a*) The object of a company is to supply boats for a ferry. Is the company competent to employ the boats, when not wanted for the ferry, in excursion ? (Pages 571-572)

3 THE FORMATION OF A COMPANY

ESSENTIAL STEPS

Before a company can be formed the following steps must be taken :

1. The Memo and the Articles must be prepared. These two documents must be filed when application is made for the registration and incorporation of the company. The Companies Act lays down rules regarding the preparation of the memorandum. Schedule I to the Act of 1956 contains four model forms for use in different cases.

2. If it is proposed to have a paid up capital or more than Rs. 3 crores, sanction of the Central Government must be obtained under the Capital Issues (Control) Act, 1956. Formerly, sanction was required up to Rs. 1 crore or more. The exemption limit was raised to Rs. 3 crores by an order of the Central Government on 31st March, 1978. The exemption is not available to monopoly companies subject to the Monopolies and Restrictive Trade Practices Act (MRTPA) of 1969 and companies with foreign shareholding of more than 40%.

3. If the company to be formed intends to participate in an industry which is included in the Schedule annexed to the Industries (Development and Regulation) Act, 1951, a licence must be obtained under that Act.

4. The company must be registered in accordance with the provisions of the Companies Act, 1956 and the Certificate of Incorporation must be obtained.

In the case of a public company, the following further steps are required to be taken before it can commence business.

5. The Prospectus or the Statement in lieu of Prospectus must be issued and registered with the Registrar.

6. The minimum subscription must be raised and thereafter the allotment of shares must be made.

7. The Certificate for the Commencement of Business must be obtained from the Registrar.

PROCEDURE OF REGISTRATION AND INCORPORATION

For the registration of a company, the following documents, together with the necessary fees, must be submitted to the Registrar of Companies of the State in which the registered office of the company will be situated.—Sec. 33.

1. The Memorandum of Association, prepared in accordance with the provisions of the Companies Act, and signed by at least 7 persons in the case of public companies and 2 persons in the case of private companies.

2. The Articles of Association, in case of unlimited companies, companies limited by guarantee and private companies limited by shares.

3. A declaration by any of the following persons, stating that all the requirements of the Act have been complied with—an advocate, an attorney, a pleader, a chartered accountant, or a person named in the articles as director, manager or secretary of the company.

4. A duly signed list of persons have consented to be directors of the company, their consent in writing and the signed agreement with every such director to take the number of shares required to qualify as director. These are not required in the case of private companies and companies not having a share capital.

5. The Registration fees of a Company is fixed on a graduated scale on the amount of nominal capital or the number of members. There is also a filing fee per document.

Comments

If the Registrar is satisfied that all the requirements of the Act have been complied with, he will register the company and issue a certificate called the Certificate of Incorporation.

The purpose of forming the company must be lawful. *Example* : A company was formed with the object of carrying on unauthorised lotteries. Registration was refused : *More, Ex parte*.[1]

THE CERTIFICATE OF INCORPORATION

The certificate issued by the Registrar after a company is registered is called the Certificate of Incorporation.

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[1] (1931) 2 K.B. 197

Section 35 of the Act states that the Certificate of Incorporation is conclusive evidence about the following matters.

1. All the requirements of the act has been complied with any respect of registration and matters precedent and incidental thereto.

2. The association is a company authorised to be registered and duly registered under the Act.

3. The legal existence of the company begins from the date of issue of the certificate.

Once the Certificate is issued, the incorporation cannot be challenged even though there were irregularities prior to registration.

Case Law :

Incorporation was upheld in the following cases.

(*a*) Memo materially altered after signature but before registration. *Peel's case.*[1]

(*b*) Signatories to the memo all infants. *Moosa* v. *Ebrahim.*[2]

(*c*) The shares of the company were allotted before the issue of certificate of incorporation. *Jubilee Cotton Mills Ltd* v. *Lewis.*[3]

(*d*) The objects of a company were all found to be illegal. *Bowman* v. *Secular Society Ltd.*[4]

Effects of registration (Sec. 34)

As soon as a Company is registered and a certificate of incorporation is issued by the Registrar, three important legal consequences follow :

1. The company acquires a distinct legal entity.
2. It secures a perpetual succession.
3. Its property is not the property of its shareholders.

PROMOTERS

Definition

The term Promoter is not defined in the Act. Promoter is a word which is used to describe the persons who initially plan the formation of a company and bring it into existence.

"A person who originates a scheme for the formation of the company, has the Memo and the Articles prepared, executed and registered, and finds the first directors, settles the terms of the preliminary contracts and prospectus (if any) and makes arrangements

[1] (1867) L.R. 2 ch. App. 674
[2] 40 Cal 1 (P.C.)
[3] (1924) A.C. 958
[4] (1917) A.C. 406

for advertising and circulating the prospectus and placing the capital is a Promoter."—Palmer, "*Company Precedents*".

"A person who has not done all these things but has done a substantial part of them so that he may be regarded as having an effective hand in the formation or floatation of the company is also a promoter".—Sengupta, "*Indian Company Manual*".

Bowen L.J., in *Whaley Bridge Printing Co.* v. *Green*,[1] stated that the term promoter is not a term of law, but of business "usefully summing up in single word, a number of business operations familiar to the commercial world by which a company is generally brought into existence."

Sometimes company promotion is undertaken by promoting companies or syndicates formed for the purpose. The rights and liabilities of such companies or syndicates are the same as those of individual promoters. The directors of such companies and members of such syndicates are personally responsible if any breach of trust or fraud is committed.

Promoter's Remuneration

But for any contract a promoter has no right to get any remuneration for the services rendered by him in promoting the company. In practice, however, he takes remuneration for his work. The usual methods of taking remuneration are as follows : (*i*) selling to the company at a profit some property purchased by the promoter before he became one ; (*ii*) taking a commission on the shares sold ; (*iii*) taking a grant of some shares of the company ; (*iv*) lump sum from the company.

The amount of remuneration and the mode of securing it is settled by the promoters themselves and are expressed in the prospectus or the memo or the articles.

Functions of the Promoter. (1) The promoter decides the company's name and asserts that it will be accepted by the Registrar of companies.

(2) He decides the details of the Company's Memorandum and Articles, the nomination of directors, solicitors, auditors, bankers and the registered office of the company.

(3) He makes arrangements for printing the Memorandum and Articles, the registration of the company and the issue of prospectus.

(4) He is responsible to bring the company into existence.

[1] (1879) 5 Q. B. D. 111

The Duties and Liabilities of Promoters

1. A promoter cannot be described as *an agent* of the Company. The contract between the promoter and the so-called agent of the company is not binding upon the company, for the company then had no existence.

2. A company cannot ratify a contract made by a promoter before the incorporation of the company because the ratifier was then not in existence. *Re Empress Engineering Co.*[1]

3. For the reasons stated in paras 1 and 2, a promoter cannot be a trustee of the company.

4. A promoter stands in a fiduciary position to the company.

5. A promoter cannot make secret profits. If any secret profit or undisclosed financial benefits is made by the promoter, the company can recover it from him. *Gluckstein* v. *Barnes*.[2] ; *Lagunas Nitrate Co.* v. *Lagunas Nitrate Syndicate*.[3]

6. The promoter is not prohibited from making profits. He can do so, provided he discloses all the facts (including the fact that a profit is being made) to the Board of Directors of the proposed company. If a person purchases some property and later decides to sell it to a company to be formed for using the property, the sale may be made as a profit. *Erlanger* v. *Sombrero Phosphate Co.*[4]

7. A promoter has got certain duties in connection with the prospectus, if any is issued, or the statement in lieu of prospectus. These duties are : (*i*) he must see that the documents contain the particulars which, according to Schedule II to the Act, they must contain ; and (*ii*) he must see that the documents do not contain any untrue statement.

8. For failure to perform these duties the promoter, (*i*) is liable to pay compensation to any person who buys shares on the basis of the erroneous prospectus or statement in lieu of prospectus and suffers damage ; and (*ii*) he may be prosecuted in the criminal courts according to the provisions of the Companies Act.

PROMOTERS AND PREINCORPORATION CONTRACTS

Before a company is formed and registered, the promoters of the company have to enter into contracts for drafting the

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[1] (1880) 16 Ch. D. 125
[2] (1900) 240
[3] (1899) 2 Ch. 392
[4] (1878) 3 A.C. 1218

necessary documents, transfer of goods and property etc. Such contracts may be called preliminary or preincorporation contracts. They are entered into before a company comes into existence. The question arises whether contract by the promoters with a non-existing company are enforceable or not. The rules regarding the subject are summarised below.

1. A company is not bound by any preincorporation contract before its incorporation even where it enjoys the benefit of the preincorporation contract entered into on its behalf.

The company cannot enforce preliminary contract. See Example (a) below.

2. The other party to the contract is not bound by the preincorporation contract. See Example (*b*) below.

3. A company after it is formed, cannot ratify a preincorporation contract. Because by the Contract Act, a non-existing principal cannot ratify a previous contract. (See pp. 180-181)

4. The promoters and the agents who had formed the company may incur personal liability for a preincorporation contract made on behalf of company not yet in existence, such a contract is considered to have been entered into presonally by the promoters. See Example (*c*) in the next page.

5. *Specific Performance* : Sections 15 and 19 of the Specific Relief Act, 1872 provide that if the promoters and agents of a company enter into a preincorporation contract and such a contract is within the terms of incorporation, specific performance may be obtained by or enforced against the company, if the company has accepted contract and has communicated such acceptance to the other parties.

Comment : A company can, after its incorporation, enter into a new contract with the other parties. In this case the liability of the promoters and the agents comes to an end. The obligation and rights of the company and the other parties will depend on the new contract.

Examples :

(*a*) X. Co., a firm of solicitors, was appointed by Y. a promoter of E. Ltd. (which was to be incorporated later) to prepare the Memorandum and Articles of the company. X & Co. incurred costs of registration of the company. Held that they were not entitled to recover these costs from the company. *Re English and Colonial Produce Co. Ltd.*[1]

[1] (1906) 2 Ch. 435 (A.C.)

(*b*) N made a contract with S. Ltd. for and on behalf of N. Ltd. for selling tinned ham to S. Ltd. The contract was signed by him as "N". The said N. Ltd. was not incorporated on the date of the contract but it became so afterwards. Thereafter market price of ham fell and S. Ltd. refused to take delivery of tinned ham. On an action brought by N. Ltd. it was held neither this company nor N himself could enforce it on the defendants S. Ltd. on the grounds that contract by a nonexistent company is a nullity. *Newborne* v. *Sensolid (Great Britain) Ltd.*[1]

(*c*) A, a promoter of X. Co. Ltd. made a contract in his own name, on behalf of X Co. Ltd. with K for the purchase of wine costing £ 900. The Company was registered afterwards. The company obtained delivery of the wine from K and consumed it. Before payment X Co. Ltd. went into liquidation. It was held that the promoter A was personally liable on the contract. *Kelner* v. *Baxter.*[2]

PROSPECTUS

The prospectus is the basis on which the investors at large get an idea about the prospectus of the company.

Definition

A prospectus has been defined in the Act as, "any document described or issued as a prospectus and includes any notice, circular, advertisement, or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any share in, or debentures of a body corporate."—Sec. 2(36).

The words, "inviting deposits from the public or" were added by the Companies (Amendment) Act, 1974.

Characteristics

The essential characteristics and the features of the prospectus are the following :

1. It is a document described or issued as a prospectus.

2. It includes any notice, circular, advertisement inviting deposits from the public or other document.

3. It is an invitation to the members of the public.

4. The public is invited to subscribe the shares or debenture of the company.

5. The term public does not mean an invitation of very large number of people. It is enough if the invitation is to a section

[1] (1954) 1 Q.B. 45 [2] (1866) L.R. 2 C.P. 174

of the public. From the examples, stated below, if follows that there must be some degree of publicity even though it may be of a small scale.

Examples :

(*a*) Three thousand copies of prospectus were distributed among the members of this company. *Re South of England Natural Gas Co. Ltd.*[1]

(*b*) An invitation to a few friends and relatives or to the customers of the promoter does not institute a prospectus. *Shorwell* v. *Combined Incandescent Mantles*.[2]

6. Prospectus is the document through which the company secures the capital needed for carrying on its business. Any document having this object, comes within the definition of prospectus. But an advertisement for securing business or trade, is not a prospectus.

Form and Contents of the Prospectus

Schedule II to the Companies Act specifies a list of particulars which must be included in the prospectus. The *principal items* are the following :

(1) Principal objects of the company and particulars of signatories of the memorandum of the company and shares subscribed by them ;

(2) number and classes of shares and extent of interest of holders and particulars regarding debentures and redeemable preference shares ;

(3) the rights in respect of capital and dividends attached to different classes of shares ;

(4) particulars regarding the directors, managing agents, secretaries and treasurers, etc. and of the contract fixing the remuneration of managing agents, etc ; (Managing Agency & Secretaries and Treasurers have been abolished).

(5) the minimum amount of subscription and amount payable on application ;

(6) time of opening of subscription list ;

(7) preliminary expenses incurred ;

(8) particulars in regard to the company and other listed companies under the same management which made any capital issue during the last 3 years ;

(9) details of any premium or under-writing commissions paid ;

[1] [1911] 1 Ch. 573 [2] (1907) 23 T.L.R. 482

(10) particulars of reserves including reserves capitalised ;
(11) nature and extent of interest of every director and promoter ;
(12) names and addresses of the auditors of the company ;
(13) in case of existing companies, a report by the auditors showing the profit and loss and assets and liabilities of the company, rates of dividend paid for five years preceding issue of prospectus and particulars regarding subsidiaries ;
(14) whether the prospectus is issued at the time of the formation of the company or subsequently ;
(15) the nature and extent of restrictions upon members at company meetings ;
(16) restrictions upon the powers of the directors ;
(17) voting rights, capitalisation of reserves and surplus of revaluation ;
(18) inspection of balance sheet and profit and loss account ;
(19) The following reports are to be annexed to the prospectus (*i*) report by auditors and (*ii*) report by the accountant.

THE LEGAL REQUIREMENTS OF PROSPECTUS

1. Time

A prospectus is to be issued after the incorporation of the company.

2. Particulars

The prospectus must contain all the particulars listed in Schedule II to the Companies Act. (See above).

3. Date

The prospectus must be dated and this date will be considered to be the date of publication unless otherwise proved—Sec. 55.

4. Signature

The prospectus must be signed by every person mentioned therein as director or proposed director or his agent.

5. Copy of prospectus

Every application form for shares, issued by the company, must be accompanied by a copy of the prospectus except (*i*) application forms issued in connection with a bona fide

invitation to a person to enter into an under-writing agreement, and (*ii*) application forms issued to existing members and debenture-holders.—Sec. 56(3).

6. Statement by expert

A statement, relating to the company, by an expert, can be included in the prospectus only if the expert concerned is not engaged or interested in the formation, promotion, or the management of the company. (Sec. 57). The statement of an expert can be included only if he has, in writing, authorised its issue. (Sec. 58). The term expert includes an engineer, valuer, accountant and any other person whose profession gives authority to a statement made by him.

7. Deposits

Deposits are not to be invited without issuing an advertisement. The Central Government may, in consultation with the Reserve Bank of India prescribe the limits, the manner and the conditions subject to which deposit may be invited or accepted by a company either from the public or the members. The advertisement must include a statement showing the company's financial position, issued by the company and in such form, or in such manner, as may be prescribed. The Rules shall prescribe how the deposit is to be continued or repaid.

The company and the officer which contravene the above rules shall be punishable. These rules are not applicable to a banking company and such other company as the Central Government after consultation with the Reserve Bank of India, specify in this behalf.—Sec. 58A, Companies (Amendment) Act, 1974. Such rules are valid. *D.C. & G. M. Co. Ltd.* v. *Union of India.*[1]

The provisions of this Act relating to prospectus shall, so far as may be, apply to an advertisement referred above.—Sec. 58B, Companies (Amendment) Act, 1974.

Section 58A of the Companies Act has been amended in 1988. The amended provision states.

"(3A) Every deposit accepted by a Company after the commencement of the Companies (Amendment) Act, 1988, shall,

[1] AIR (1983) Supreme Court 937.

unless renewed in accordance with the rules made under sub-Section (1), be repaid in accordance with the terms and conditions of such deposit".

Section (9) : If a Company has failed to repay any deposit, in accordance with the terms and conditions of such deposit, the Company Law Board may, direct by order, the Company to make repayment of such deposit within such time and subject to such conditions as may be specified in the order.

One who fails to comply with any order made by the Company Law Board under sub-Section (9) shall be punishable with imprisonment and fine.

8. Registration

Before a prospectus is issued, it must be registered with the Registrar of Companies. Copies of relevant documents (*e.g.*, consent of directors and experts to the issue of the prospectus and copies of contracts) have to be filed when application is made for registration. If the relevant documents are not filed or if the prospectus does not comply with with the provisions of the Act, registration will be refused. No prospectus can be issued more than 90 days after a copy of it is filed for registration.—Sec. 60.

9. Terms of contracts

The terms of any contract, mentioned in the prospectus, cannot be varied after registration of the prospectus except with the approval of the members in a general meeting.—Sec. 61.

10. Prospectus by a foreign company

A prospectus issued by a foreign company, with a view to selling shares in India, must include certain additional particulars. (See p. 559)

11. Penalty for non-compliance

If the aforesaid rules, relating to the matters to be included in the prospectus, are not complied with, any person who is knowingly a party to the issue thereof, shall be punishable with a fine which may extend to Rs. 5000.—Sec. 59.

12. Defence

A person charged with non-compliance of the aforesaid rules will be excused in the following cases : [Sec. 56(4).]

(*a*) as regards any matter not disclosed, if he proves that he had no knowledge thereof; or

(*b*) if he proves that the non-compliance or contravention arose from an honest mistake of fact on his part; or

(*c*) if the non-compliance or contravention was in respect of matters which, in the opinion of the Court dealing with the case, was immaterial or was otherwise such as ought (having regard to all the circumstances in the case) reasonably to be excused.

MISSTATEMENTS IN THE PROSPECTUS

Liability for not stating particulars

The public invest money in the purchase of shares and debentures of companies on the basis of statements contained in the prospectus. Misstatements and false statements in the prospectus are instruments through which dishonest company promoters may practise fraud on the public. To prevent such practices the law imposes certain duties and liabilities on all persons who are responsible for the issue of the prospectus. One of the duties has already been mentioned *viz.*, the duty of including in the prospectus, the particulars mentioned in Schedule II to the Act. (See p. 594)

Liability for untrue statement

The authors of the prospectus have to see that the prospectus contains no untrue statement likely to mislead the public. Section 65 of the Companies Act lays down that the term "untrue statement" in connection with a prospectus shall be deemed to include :

(*a*) a statement which is misleading in the form and context in which it is included, and

(*b*) an omission (of any matter) which is calculated to mislead.

Thus, the term untrue statement or misstatement, is used in a wide sense. It includes not only *false statements* but also statements which produce a wrong impression of actual facts. *Concealment* of a material fact also comes within the category of misstatement.

Example :

Lord Kylsant, the managing director of Royal Mail Steam Packet Company, issued a prospectus inviting subscription to debentures of the company. In the prospectus it was stated that the company was in a good position and that dividends were regularly paid. But the prospectus omitted to state that there were large losses in several years and that in those years dividends were paid out of reserves. It is apparent that the prospectus tried to create a false notion of company's soundness. It was held by the House of Lords that Lord Kylsant wilfully issued a false prospectus and he was convicted under the criminal law. *Rex* v. *Kylsant*.[1]

Persons liable for untrue statements in the prospectus

Section 62(1) of the Act provides that the following persons are liable (and punishable) for untrue statements in the prospectus :

(*a*) every person who is a director of the company at the time of the issue of the prospectus ;

(*b*) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time ;

(*c*) every person who is a promoter of the company ; and

(*d*) every person who has authorised the issue of the prospectus.

The extent of the liability for untrue statements

The Companies Act imposes the following liabilities on the persons responsible for untrue statements in the prospectus.

(*a*) *Civil Liability* : Section 62(1) provides that such persons are liable to pay compensation for any loss or damage which any person may suffer from the purchase of any share or debenture on the basis of the untrue statement.

A person who has been made to pay compensation under this section can claim contribution from the others who were associated with him in the issue of the prospectus, unless it appears that he was guilty or fraud while the others were not.

(*b*) *Criminal liability* : Section 63(1) provides that every person who has authorised the issue of a prospectus containing untrue statements, shall be punishable with imprisonment which

[1] (1932) 1 K. B. 442

may extend to two years or with fine which may extend to Rs. 5000, or both.

(*c*) *Liability under the law of fraud* : A person who has suffered damage by purchasing shares or debentures on the basis of untrue statements in the prospectus may, instead of proceeding under Section 62(1) of the Companies Act, take action under the general law of fraud. The law relating to fraud provides that when a person is induced to enter into a contract by fraud, he is entitled to rescind the contract and to get compensation for the loss or damage which he may have suffered. The aggrieved shareholder or debenture holder must prove that (*i*) there was fraudulent misstatement (*ii*) misrepresentation relating to material facts (*iii*) the shareholders had purchased the share on the basis of prospectus, and (*iv*) that he had been actually deceived. *Derry* v. *Peek*.[1]

(*d*) *Penalty for fraudulently inducing persons to invest money* : Any person who, either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into, or offer to enter into—

(*a*) any agreement for, or with a view acquiring, disposing of, subscribing for, or underwriting shares or debentures ; or

(*b*) any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuations in the value of shares or debentures ;

shall be punishable with imprisonment for a term which may extend to five years, or with fine which may extend to ten thousand rupees, or with both.—Sec. 68.

In Sec. 68 the word 'recklessly' is used. A 'reckless' statement or promise is one which is made without any real fact or heedless of its base. *R.* v. *Grumwald*.[2]

Defences available in an action on the prospectus

The parties against whom proceedings have been taken for untrue statement in the prospectus are allowed to use certain pleas in their defence. The defences are summarised in the next page :

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[1] (1889) 14 A.C. 337 [2] (1961) W.L.R. 606

A. *Defences against the civil liability imposed by Sec.* 62(1) : Sec. 62(2) provides that no decree for damages will be passed if the person charged can prove any of the following facts.

1. *Issue without authority* : He withdrew his consent to become a director of the company before the issue of the prospectus and it was issued without his authority or consent.

2. *Issue without knowledge* : The prospectus was issued without his knowledge or consent and on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent.

3. *Withdrawal of consent* : After the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statements therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and of the reason thereof.

4. *Statement by an expert* : If the statement alleged to be untrue purports to be a statement of an expert or a copy or extract from such a statement or of a valuation report of an expert, the person charged can escape liability if he can prove the following : (*i*) it is a fair and correct copy or representation or extract of the expert's statement ; (*ii*) he had reasonable grounds to believe and did believe (up to the time of the issue of the prospectus) that the person making the statement was competent to make it ; (*iii*) the expert had given his consent to the issue of the prospectus ; and (*iv*) the expert had not withdrawn his consent before registration of the prospectus or allotment thereunder.

5. *Copy of official statement or document* : If the statement alleged to be untrue is one purporting to be from an official statement or a public official document, the person charged can escape liability if he can show that it is a fair and correct representation or copy or extract from the official statement or public official document.

6. *True statement* : As regards statements other than those of experts or those contained in official documents, the person charged can escape liability if he can prove that he had reasonable grounds to believe, and did, up to the time of the allotment of shares or debentures, believe that the statement was true.

B. *Defences available to an expert* : An expert whose opinion was included in the prospectus, can use the following defences.—Sec. 62(4).

1. *Withdrawal of consent* : Having given his consent to the issue of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration.

2. *Knowledge of untrue statement* : After delivery of a copy of the prospectus for registration and before allotment there under, he, on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal, and of the reason thereof.

3. *True statement* : He was competent to make the statement and he had reasonable ground to believe, and did, up to the time of the allotment of the shares or debentures, believe that the statement was true.

C. *Defences against criminal liability* : A person charged in a criminal court under Section 63(1) will be acquitted if he can prove either of the following :

(*a*) that the statement *was immaterial*, or

(*b*) that he had reasonable ground to believe, and did, up to the time of the issue of the prospectus, believe that the statement *was true*.

Loss of the right of rescission and damages

There have been a large number of cases in English courts regarding the prospectus and the shareholder's rights thereon. It has been held that the shareholder has no rights, either to damages or to rescission of the contract of purchase, in the following cases :

1. *Purchase not on the basis of the prospectus* : A person who has not purchased the shares on the basis of the prospectus, is not entitled to any remedy. A person who has purchased shares from an existing shareholder cannot be said to have purchased the shares on the basis of the prospectus, and is not entitled to any relief if there are untrue statements in the prospectus. *Peek* v. *Gurney*.[1]

2. *Opinion or expectation* : The statement complained of must come within the definition of untrue statement. A mere expression of opinion or expectation gives no ground of action. *Karberg's case*.[2]

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[1] (1873) 6 H.L. 377 [2] (1892) 3 Ch. 1

3. *Confirmation* : If the shareholder does any act which amounts to confirmation of the purchase (e.g., if he accepts dividends) the right to rescind the contract or get damages is lost.

4. *Laches* : The shareholder must bring his action without undue delay, otherwise he loses his right.

STATEMENT IN LIEU OF PROSPECTUS

A public company having a share capital and not issuing a prospectus must at least 3 days before the first allotment of shares or debentures, file with the Registrar for registration *a statement in lieu of prospectus*. The statement must be in the form prescribed in Schedule III to the Act. The prescribed form provides for the disclosure of all material facts relating to the company.—Sec. 70(1)

If the statement in lieu of prospectus contains any untrue statement, the persons responsible for the issue thereof may be punished by imprisonment which may extend to 2 years or with fine which may extend to Rs. 5,000 or with both.—Sec. 70(5).

Statement in lieu of Prospectus like in the Prospectus, constitutes the basis of the contract of purchase of shares between the company and the shareholder. Liabilities for misstatements and false statement are the same as in a prospectus.

PROSPECTUS BY IMPLICATION

Section 64 provides that certain documents are to be included within the term Prospectus by implication of law. Where a company allots or agrees to allot any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made, is deemed to be a prospectus issued by the company.

Subject to the modifications stated below, all the rules laid down in the Act, regarding prospectuses, (contents, liability for misstatements etc.) apply also to a prospectus by implication :

1. The following additional matters must be stated in it— the net amount of consideration to be received by the company in respect of the shares or debentures ; and the place and time at which the contract (under which the shares or debentures are to be allotted) may be inspected.

2. The persons making the offer of sale to the public are to be deemed directors of the company for the purpose of registration of the prospectus.

3. Where the person making the offer is a company, the prospectus may be signed by any two directors ; where the offer is made by a firm, it may be signed by not less than one-half of the partners.

Unless the contrary is shown, an allotment or agreement to allot shares or debentures will be deemed to have been made with a view to sale to public, under the following circumstances :

1. When the offer for sale was made within six months after the allotment or agreement to allot.

2. When at the date of the offer for sale, the whole consideration to be received by the company for the shares or debentures had not been received by it.

MINIMUM SUBSCRIPTION

Where shares are offered to the public for subscription, the prospectus must mention the minimum amount which must be raised by the issue of shares before the company can commence business.—Schedule II, clause 5.

The minimum subscription is to be fixed by the directors or by the persons who have signed the memorandum. Its amount is to be determined by taking into account the following expenses :

(1) the purchase price of any necessary property :
(2) the preliminary expenses, including commissions payable for the sale of shares ;
(3) repayment of any moneys borrowed by the company for the above two purposes ;
(4) working capital ;
(5) any other necessary expenditure.

The information regarding each of the above items must be stated under each head.

The amount stated in the prospectus as minimum subscription, is to be reckoned exclusively of any amount payable otherwise than in money.

Shares cannot be allotted until applications have been received sufficiently to cover the minimum subscription.

ALLOTMENT OF SHARES

Definition

"Allotment means the appropriation to an applicant by a resolution of the directors of a certain number of shares in response to an application. Shares so allotted are not, in general specific shares identified by number; the numbering is left till later."—Palmer's Company Law, 19th ed. p. 104.

Rules regarding allotment

The rules regarding allotment are summarised below.

1. Application Form

The prospectus is an invitation to the public to purchase shares. Persons intending to purchase shares have to apply in a form prescribed in the prospectus for the purpose and called the "application form." The prospectus also fixes the time when the applications will be opened and the allotment of shares to the applicants will be made. The time is known as "the time of opening of the subscription lists." Applicants to whom shares have been allotted are informed by a letter. This letter is called, "the notice of allotment." As per SEBI guidelines, application money cannot be less than Rs. 2,000 and that issue must be kept open for at least 3 working days.

2. Result of a contract

Membership of a company by purchase of shares is the result of a contract. The application by the intending shareholder is the "offer" for the purchase of shares. Allotment by the directors is the "acceptance of the offer". The notice of allotment is the "communication of the acceptance". Each of these stages in the formation of the contract must conform to the rules laid down in the Contract Act.

3. Conditional offers and acceptance of shares

Conditions are usually printed on the application form. One very common condition is that in case of over-subscription, the number of shares allotted to each subscriber will be proportionately less than the number of shares applied for.

But conditional acceptance is usually invalid. No condition should be attached to the acceptance of the offer to purchase

shares. If the acceptance introduces a new term it will be a new offer by the company and it shall not be effective unless it is accepted. *Jackson* v. *Turquand.*[1]

4. By the proper authority

The allotment of shares is to be done by the board of directors of the company. Allotment can be delegated to some persons or a Committee, provided there is a provision in the Articles of the company. Allotment made by any other than the proper authority is void.

5. Within a reasonable time

The allotment must be made within a reasonable time, otherwise the applicant is not bound to take the shares. The offer to buy the shares is deemed to be revoked if there is an unreasonable delay in accepting the offer. *Ramsgate Victoria Hotel Co.* v. *Montefiore.*[2]; *Indian Co-operative Navigation* v. *Padamsey.*[3] As per SEBI guidelines, if allotment is not made within 30 days from close of issue, interest @ 15% must be paid.

6. Application in a fictitious name

Any person who (a) makes in a fictitious name an application to a company for acquiring, or subscribing for, any shares therein, or (b) otherwise induces a company to allot, or register any transfer of, shares therein to him, or any other person in a fictitious name shall be punishable by imprisonment up to 5 years. This provision must be printed in every prospectus and application form.—Sec. 68A.

Restrictions

The Companies Act prescribes the following restrictions on the allotment of shares :

1. Opening of subscription list

No allotment can be made until the beginning of the 5th day after the publication of the prospectus or such later time as may be prescribed for the purpose in the prospectus, (Sec. 72). The 5th day is to be counted from the date when the prospectus

[1] (1869) H.L. 305
[2] (1866) L.R. 1 Ex. 109
[3] 36 Bom. L.R. 32

was published in a newspaper or was otherwise notified to the public. The object of this rule is to provide sufficient time to the public to send the applications.

2. Revocation of the application

An application for shares cannot be revoked until after the expiration of the 5th day *after* the time of opening of the subscription lists, except in one case. If any of the persons responsible for the issue of the prospectus, gives public notice of withdrawal of his consent to the issue of the prospectus, any of the applicants can revoke his application, whereupon no shares can be allotted to him.

3. Punishment

An allotment of shares prior to the time prescribed under this rule is not void. But the directors making such allotment are liable to punishment.

4. Minimum subscription

No allotment can be made until the amount fixed as the minimum subscription has been received.—Sec. 69(1).

5. Application money

The amount payable on each share, with the application form, shall not be less than 5 per cent of the nominal value of the share.—Sec. 69(3).

6. Deposit in a Scheduled Bank

All moneys received from the applicatants must be kept in deposit in a scheduled bank until the certificate to commence business has been obtained, or, (where such certificate has already been obtained) until the entire amount payable on applications for shares in respect of the minimum subscription has been received by the company.—Sec. 69(4).

7. Return of Money

If the minimum subscription is not raised or if, for any other reason, allotment could not be made within 120 days from the date of publication of the prospectus, the directors must forthwith return the moneys received from the applicants. No interest is

payable if the money is refunded within 130 days. Thereafter, the directors are, jointly and severally, liable to pay interest at 6 per cent per annum from the 130th day to the day of repayment. But a director shall not be so liable if he proves that the default in the repayment of the money was not due to misconduct or negligence on his part.—Sec. 69(5).

8. Statement in lieu of Prospectus

A public company which has not issued any prospectus must, at least 3 days before the first allotment of shares, deliver to the Registrar for registration, a Statement in lieu of Prospectus, signed by every director or proposed director or his agent in the form prescribed in Schedule III of the Act.—Sec. 70.

9. Stock Exchange recognition

Where the prospectus states that application has been made or will be made for the shares (or debentures) being dealt with in a stock exchange, the application necessary for securing permission of the authorities of the stock exchange must be made before the 10th day after the first issue of the prospectus. The *name* of stock exchange *must be stated.* Any allotment, made on an application based on such a prospectus, becomes void if stock exchange permission is not applied for or if such permission is not granted within 10 weeks from the date of the closing of the subscription list. The company must thereupon return all moneys received from the applicants of shares. No interest is payable if the moneys are returned within 8 days. Thereafter, interest is payable at 12%—Sec. 73. Companies (Amendment) Act, 1974.

Section 73 of the Companies Act has been amended and the amended section provides that all public issues of every Company must be listed with recognised stock exchanges.

If a Stock Exchange refuses to list the shares of a public company, the company can appeal to the Central Government.—Sec. 22 of Securities Contracts (Regulation) Act, 1956.

Section 73(2A) provides that where "the moneys received from applications for shares or debentures are in excess of the aggregate of the application moneys relating to the shares or debentures in respect of which allotments have been made, the Company shall repay the moneys to the extent of such excess",

within eighth day. The Company and every director of the Company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at such rate, not less than four per cent, and not more than fifteen per cent, as may be prescribed.

Effects of an irregular allotment

An allotment made in violation of sections 69, 70 and 73 (summarised in rules 1 to 7 above) has the following consequences :

1. *Option* : The allotment becomes voidable *at the option of the shareholder.* The option, to avoid the contract, must be exercised within 2 months of the holding of the statutory meeting or, where no statutory meeting is required to be held or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment. The option to avoid can be exercised even if the company is in course of liquidation.—Sec. 71(1) and (2).

2. *Compensation* : Any director knowingly or wilfully contravening the rules or authorising the contravention, shall be liable to pay compensation to the shareholders concerned for any loss or damage suffered. The suit for compensation must be brought within 2 years of the date of allotment.—Sec. 71(3).

3. *Fine* : "The validity of an allotment shall not be affected by any contravention of the foregoing provisions of this section ; but in the event of any such contravention, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees."—Sec. 72(3).

4. *Void* : Any allotment made in violation of Section 73 is void. (See para 9 above.)

THE RETURN AS TO ALLOTMENT

Whenever a company having a share capital makes any allotment of its share, it must within 30 days thereafter file with the Registrar a return of the allotment, giving full particulars of the allotment made.—Sec. 75.

Allotment means appropriation out of the previously unappropriated capital of a company of a certain number of shares to a person. In this sense the re-issue of a forfeited share to a

person is not allotment, within the meaning of Sec. 75.—*Sri Gopal Jalan & Co.* v. *Calcutta Stock Exchange Association & ors.*[1]

COMMENCEMENT OF BUSINESS

A public company, having a share capital and *issuing a prospectus*, cannot commence business until the Registrar issues a certificate known as the "Certificate of Commencement of Business". This certificate is issued after the following formalities have been complied with.—Sec. 149(1) :

(*a*) The minimum subscription has been raised.

(*b*) Every director has paid the moneys payable, on application and an allotment, for the shares taken up by him.

(*c*) No money is repayable for failure to obtain stock exchange recognition for the shares, where such recognition was promised.

(*d*) A duly verified declaration by a director or the secretary has been filed with the Registrar stating that the above requirements have been complied with.

A public company having a share capital but *not issuing a prospectus*, will get the commencement certificate if the following conditions are satisfied.—Sec. 149(2) :

(*a*) A statement in lieu of prospectus has been filed with the Registrar.

(*b*) The directors have paid the moneys due from them on account of shares.

(*c*) A declaration by a director or the secretary has been filed with the Registrar stating that condition (*b*) has been satisfied.

The amending Act of 1965 adds a new sub-section (2A) to Section 149 which places certain further restrictions on the commencement of business in certain cases.

Section 13 of the Act, as amended by the Act of 1965, provides that the Memorandum of Association of a company *formed after the commencement of the Act of* 1965 must state separately (*a*) the main objects of the company together with objects incidental and ancillary to them and (*b*) other objects, if any. (See p. 567). The new subsection (2A) of Sec. 149 provides that (1) in the case of such a company, if it starts any business coming under (b) above, *viz.*, other objects and (2) in the case of a company already existing at the date of commencement of the amending Act of 1965, if it starts a new

[1] (1964) 3 S.C.R. 698 (702) (Supreme Court)

business not germane to the business it is carrying on, on that date, the following conditions must first be fulfilled.

1. The company has approved of the commencement of any such business by a special resolution passed on that behalf by it in general meeting.

2. There has been filed with the Registrar a duly verified declaration by one of the directors or the secretary that the above provision or the exception noted below has been complied with.

The new sub-section (2B) provides for one exceptional case. The Central Government may, on an application made to it by the Board of Directors, permit such new business in cases where no special resolution has been passed but where in the general meeting the votes cast in favour of commencing such business is more than the votes cast against it.

Contravention of the provisions relating to commencement of business a punishable by fine which may extend to Rs. 500 per day.

The restrictions on the commencement of business, as provided in Sec. 149, apply to all public companies having a share capital, whether issuing a prospectus or not.

A company may enter into contracts before the date of commencement of business but such contracts remain provisional up to the commencement date and become binding on that date.

EXERCISES

1. State the usual steps to be taken in the formation of a company under the Companies Act, 1956. (Page 587)
2. What do you understand by certificate of incorporation of a company? What are the principal documents to be filed for purposes of incorporation of company? (Pages 587-588)
3. What are the formalities for incorporation of a company? (Pages 587-588)
4. Define the promoters. State the duties and liabilities of promoters. (Pages 589-590)
5. Can a Company be a party to a contract before it has come into an existence? (Page 591)
6. Define Prospectus. State the contents of a Prospectus. (Pages 593-594)
7. Is a Company bound by a contract entered into by the promoters on its behalf before its incorporation? (Page 591)
8. What is a 'prospectus'? What does it contain? What is 'misstatement in a 'prospectus'? Who is liable? What is the nature of the liability? (Pages 593, 598)

9. What are the contents of the prospectus of a company ? Must a company file a prospectus before it can commence business ? (Pages 593-594, 608)
10. Define the term 'statement in lieu of prospectus'. State the particulars required to be mentioned in the 'statement in lieu of prospectus'. (Page 603)
11. Who is an expert in relation to the prospectus of a company ? State the conditions which must be satisfied before a report by an expert can be published in prospectus. (Page 595)
12. What are the rules regarding invitation of deposits by companies ? (Page 595)
13. Define 'irregular allotment' of shares. What is the effect of such an allotment ? (Page 609)
14. What is minimum subscription ? In what case is minimum subscription necessary and what are the consequences of its not being subscribed ? (Page 604)
15. Enumerate the conditions to be fulfilled by a public company before it can commence business. (Page 610)
16. Define the following terms as used in Companies Act : (*a*) Registration of a Company ; (*b*) Pre-incorporation contracts ; (*c*) Company Deposits ; (*d*) Misstatement in the Prospectus ; (*e*) Minimum Subscription ; (*f*) Return as to allotment ; (*g*) Statement in lieu of Prospectus. [Pages (*a*) 588 ; (*b*) 591 ; (*c*) 596 ; (*d*) 598 ; (*e*) 604 ; (*f*) 609]
17. *Problems* : (1) A mining company stated in its prospectus that the company had taken a lease of land containing first grade coal. Later on, it turned out that the coal was of much inferior quality. What legal action a subscriber to share capital may take against the company ? (Page 598)
    (2) A prospectus was issued on the basis of the report of an expert who examined the property purchased by the company. If such report contained false statements of facts which were relied upon by a shareholder, what will be his remedy ? (Page 600)
    (3) The promoter of a Company purchased wine from Q on behalf of the Company. The Company was incorporated but, before paying the price, went into liquidation. Can the claim of Q is maintainable against the company ? (Page 592)
18. Comment on : The term 'promoter' is a term of business and not of law. (Page 589)
19. Define the term 'promoter'. (Page 589)
20. Write short notes : Certificate of Incorporation ; Commencement of business ; Preliminary expenses. (Pages 588 ; 610 ; 604)
21. What is a statement in lieu of prospectus ? (Page 603)
22. Discuss fully the effects of misstatement made in the prospectus of a company. (Page 598)

4 CAPITAL, SHARES AND SHAREHOLDERS

SHARE CAPITAL

The term "capital", in connection with company formation, may mean any one of the following things :

1. Nominal Capital or Authorised Capital

Nominal Capital or Authorised Capital is the total face value of the shares which the company is authorised to issue by its memorandum of association. The total share capital of a company is also called its Registered Capital.

The full authorised capital may not be needed by a company at the time it commences business. A company may issue less than the authorised capital, reserving the right to raise further moneys by the sale of the unissued shares at a later time.

2. Issued Capital

Issued Capital is that part of authorised capital which is actually offered to the public for sale.

3. Subscribed Capital

Subscribed Capital is that part of issued capital which is taken up and accepted by the public.

4. Paid up Capital

Paid up Capital is the amount of money actually paid by the subscribers or credited as so paid.

5. Uncalled Capital

The unpaid portion of the subscribed capital is called Uncalled Capital. A limited company may by special resolution determine that a portion of the share capital, which has not been called up, shall not be called up except in case of Liquidation. Such uncalled capital is called Reserve Capital. (See p. 578)

SHARES

Definition

The shareholders are the proprietors of the company. Therefore a "Share" may be defined as an interest in the company entitling the owner thereof to receive proportionate part of the

profits, if any, and of a proportionate part of the assets of the company upon liquidation. A shareholder has certain rights and liabilities. Formerly it was thought that the shareholders are the proprietors of the company. Nowadays, however, there has emerged a new concept of company. The views of the Supreme Court, in the case of *National Textile Workers' Union* v. *P. R. Ramakrishnan* are quoted in p. 542 subject to the control of the Government and social objectives of the nation.

Features and Characteristics

The main characteristics of shares are stated below.

1. 'A share is not a sum of money, but is *an interest* measured in a sum of money and made up of various rights, contained in the contract.'—Farwell J. in *Borland's Trustee* v. *Steel Bros. & Co.*[1]

2. A share is an interest having a money value and made up of *diverse rights* specified under the Articles of Association. *Commissioner of Income Tax* v. *Standard Vacum Oil Co.*[2]

3. The holder of a share has certain *rights, duties and liabilities,* as stated in the Companies Act and in the Memo and Articles of a company.

4. A share is *transferable* and *heritable* subject to regulations framed in the Articles of Association of the company.

5. The shares or other interest of a member in a company is *movable property,* transferable in the manner provided by the articles of the company.—Sec. 82.

6. The shares *must be numbered* so as to distinguish them from one another.—Sec. 83.

Classification of Shares

The Companies Act of 1956 provides that after the commencement of the Act, there can be only *two types* of shares capital, *viz.*,

(*a*) Equity Shares Capital, and

(*b*) Preference Share Capital.

Preference Shares

Preference shares are those shares which are given, by the articles of the company, two privileges *viz.*, (*i*) priority in the payment of dividends over other share, and (*ii*) priority as regards return of the capital in the event of liquidation.—Sec. 85.

[1] (1901) 1 Ch. 279 [2] AIR (1966) Supreme Court 1396

4. The memo and the articles constitute *a binding contract* between the shareholder and the company.—Sec. 36.

5. All the shareholders are bound to follow the *decision of the majority* of the shareholders, unless the majority are guilty of mismanagement and oppression.—Secs. 397, 398.

6. *Cases of unlimited liability.*—(*a*) Under the Articles, directors and managers can be made liable to an unlimited extent. (See ch. 6.)

(*b*) If the number of membership of the company falls to below 7 in public companies and below 2 in private company, the existing members become *liable for the debts* of the company to an unlimited extent.—Sec. 45 (See p. 555)

REDEEMABLE PREFERENCE SHARES

Section 80 of the Act provides that a company limited by shares may, if so authorised by the articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. The rules regarding redemption are stated below :

1. Such shares shall not be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of the redemption.

2. Such shares shall not be redeemed unless they are fully paid up.

3. The premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's share premium account.

4. Where any such shares are redeemed otherwise than out of the proceeds of a fresh issue of shares, they shall be transferred to an account, to be called "the capital redemption reserve account", a sum equal to the nominal amount of the shares redeemed.

5. The capital redemption reserve account may, not withstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.—Sec. 80(5).

Subject to the aforesaid rules, the redemption of preference shares may be effected on such terms and in such manner as may be provided for by the articles of the company.

The redemption of preference shares under Section 80 of the Act, shall not be taken as reducing the amount of the authorised share capital of the company.

Where in accordance with the aforesaid provisions, a company has redeemed or is about to redeem any preference shares it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued. The issue of such new shares shall not be taken into account for the purpose of calculating the fees payable under Section 611, if the old shares are redeemed within one month after the issue of the new shares.

Section 80 has been amended and 80(5A) provides that no Company limited by shares shall issue any preference share which is irredeemable or is redeemable after the expiry of a period of ten years from the date of its issue. Company (Amendment) Act, 1988.

INCREASE OF CAPITAL : RIGHTS SHARES

There are two methods of increase of capital : (1) further issue of capital and (2) conversion of Government loans into shares.

Further issue of Capital

After the formation of a company, further shares may be issued. The rules regarding such issues are as follows.—Sec. 81(1).

Where at any time after the expiry of two years from the formation of a company or at any time after one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital of the company by allotment of further shares, the following procedure must be adopted :

1. Such new shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company in proportion, as nearly as circumstances admit, to the capital paid up on those shares at that date.

2. The offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days from the date of the offer within which the offer if not accepted, will be deemed to have been declined.

3. The offeree of the shares may renounce the offer in favour of any other person, unless the articles of the company provide otherwise.

4. After the expiry of the time specified in the notice aforesaid or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner as they think most beneficial to the company.

Shares, issued under this Section are called "Rights" shares. However, in issuing shares to public companies are required to follow the SEBI guidelines.

Exceptions :

1. Section 81(1A) provides that further shares may be offered to any person in any manner whatsoever in the following cases :

(*a*) if a special resolution to that effect is passed by the company in general meeting ; or

(*b*) if a proposal to that effect is passed by the majority of members in a general meeting *and* the Central Government is satisfied that the proposal is most beneficial to the company.

2. Section 81(3) provides that the rules contained in Section 81(1) shall not apply.

(*a*) to a private company ; or

(*b*) where the subscribed capital of a public company is increased because debenture holders or creditors were given an option (by a special resolution passed by the company in general meeting and approved by the Central Government) to convert the debentures or loans into shares of the company.

CONVERSION OF GOVERNMENT LOANS INTO SHARES

When any debentures have been issued to, or loans have been obtained from, the Government by a company, the Central Government may direct that *such debentures or loans*, or any part thereof *shall be converted into shares* of the company.— Sec. 81(4) to (7).

The Government will issue such orders if, in its opinion, it is necessary in the public interest. The terms and conditions

of such conversion are to be determined by the Government. Due attention is to be given to the financial position of the Company, the terms of the debenture or loan etc. A copy of the order is to be laid before Parliament. If the Company is dissatisfied with the terms of conversion, it can appeal to the Court whose decision will be final.

Share capital will stand increased where an order is made under section 81(4).—Sec. 94A, Companies (Amendment) Act 1974.

SHARE CERTIFICATE

Definition

The share certificate is a certificate issued under the common seal of the company specifying the number of shares held by any member. A share certificate must be issued and delivered within 3 months from date of allotment. However, Company Law Board (CLB) can extend the period up to 9 months. In case of default, CLB can order the company concerned to make good the default and to pay all costs incidental to the application.

Rules

The rules regarding share certificates are stated below.

1. A company must prepare the share certificates and have them ready for delivery, within two months of the allotment of shares and/or registration of any transfer of shares unless the conditions of the issue of the shares provide otherwise.—Sec. 113. The Company Law Board may, on being satisfied, extend the above periods to nine months.—Sec. 113(1).

2. The share certificate is *prima facie* evidence of the title of the member of such shares.—Sec. 84(1).

3. *Duplicate* : A certificate may be renewed or a duplicate issued if it (a) is proved to have been lost or destroyed, or (b) having been defaced or mutilated or torn, is surrendered to the company.—Sec. 84(2).

4. If a company renews a certificate or issues a duplicate with intent to defraud, it shall be punished with a fine and every officer in default shall be punished with a fine or imprisonment.—Sec. 84(3).

5. The Government may prescribe rules regarding the issue, renewal etc. of share certificates.—Sec. 84(4).

6. *Estoppel* : A share certificate issued by persons authorised by the company, binds the company regarding title and payment.

Examples :

(*i*) The company cannot deny the title of the certificate holder. *Dixon* v. *Kennaway*.[1]

(*ii*) If the certificate states that the shares are fully paid up the company cannot plead that they are not so. *Bloomenthal* v. *Ford*.[2]

(*iii*) A share certificate is the only legal documentary evidence of title in possession of the shareholder. *Societe Generale de Paris* v. *Walker*.[3]

(*iv*) A share certificate, being a document of title, is essential for the purpose of transfer by way of sale, mortgage or pledge. It provides marketable title and a shareholder can sue the company for a certificate. *Burdett* v. *Standard Exploration Co.*[4]

(*v*) Forgery cannot displace the real shareholder, *Barton* v. *L & N. W. Rly. Co.*[5]

SHARE WARRANT

A share warrant is a document issued by a company, stating that its bearer is entitled to the shares therein specified. It is a substitute for the share certificate. Share warrants may be issued for fully paid up shares, if the articles so provide and if the approval of the Central Government has been obtained. A share warrant may have attached coupons on the production of which the dividends due on the shares will be paid. Shares may be transferred by delivery of the warrant.—Sec. 114.

When a share warrant is issued, the name of the holder of the share certificate concerned shall be removed from the Register of Members and the number and date of the share warrant shall be noted there. Any holder of the warrant can, if he so desires, surrender the warrant and take a share certificate, whereupon his name shall be recorded in the Register of Members. The holder of a share warrant does not ordinarily possess the right to vote and exercise other right of membership, but the articles may give him that right.—Sec. 115. Conditions for issue of share warrants. (1) The shares shall be fully paid-up. (2) The Articles shall authorise the issue of share warrants. (3) Prior approval of the

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[1] (1900) 1 Ch. 833
[2] (1897) A.C. 156
[3] (1885) 11 A.C. 20
[4] (1899) 16 T.L.R. 112
[5] (1888) 38 Ch. D. 144

Central Government shall be obtained. (4) The share warrants shall be issued under the common seal of the company.—Sec. 114(1).

Examples :

(*i*) A share warrant can be transferred by delivery of possession. *Bechuanaland Exploration Co. Ltd.* v. *London Trading Bank.*[1]

(*ii*) In the case of a stolen share warrant the transferee in good faith gets a good title to it. *Webb Hale & Co.* v. *Alexandria Water Co.*[2]

DIFFERENCES BETWEEN SHARE WARRANT AND SHARE CERTIFICATE

The differences between a share warrant and a share certificate are summarised below.

1. A share warrant states that a bearer is entitled to the shares specified therein. It is a substitute of the share certificate.

2. Share warrant is issued only with fully paid up shares. The share certificate may be issued even though the share is partly paid.

3. A share and the share certificate are transferred by the procedure stated in the Companies Act and the articles of the company. A share warrant can be transferred by the delivery of the warrant.

4. A shareholder is paid dividend by the procedure stated in the Articles of the Company. (It is usually paid by cheque, sent by registered post). A share warrant may have attached coupons on the production of which dividends due on the shares will be paid.

5. The holder of a share warrant does not ordinarily possess the right to vote and to exercise other rights of membership. The holder of a share certificate exercises the right of all the membership, including the right of voting.

6. The holder of a share certificate has his name included in the Register of Members. When a share warrant is issued, the name of the holder of the share Certificate is removed and only the number and date of the warrant are noted.

STOCK

When all the shares of a company have been fully paid up, they may be converted into stock if so authorised by the articles.—Sec. 94(1)(c).

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[1] (1898) 2 Q.B. 658 [2] (1905) 93 L.T.R. 572

Conversion into stock is made because it is a convenient method of denoting the capital of the company and the interest of the members. It does not effect the rights of the members in any way.

When shares are converted into stock, notice must be given to the Registrar. The register of members must thereafter show the amount of stock held by each member instead of the amount of shares.—Sec. 150.

The provisions of the Act relating to shares only, cease to apply to shares which have been converted into stock.—Sec. 96.

"The use of the term 'stock' merely denotes that the company have recognised the fact of the complete payment of the shares, and that the time has come when these shares may be assigned in fragments, which for obvious reasons could not be permitted before."—*Per* Lord Cairns in *Morris* v. *Aylmer*.[1]

Distinction between Shares and Stocks

Shares and Stock are two methods of denoting the interest of a member of a company. According to Sec. 2(46) of the Act, the term share includes a stock, except where a distinction between them is expressed or implied.

The differences between Shares and Stock are stated below.

1. The shares of the same company are of equal nominal value. But stock may be divided into unequal amounts. Thus Rs. 100 worth of stock can be divided into two parts of Rs. 50 each.

2. Shares cannot be issued or transferred in fragments. Thus a member cannot hold half a share. But a stock can be transferred in fragments.

3. Shares may be partly paid. Shares can be converted into stock only when fully paid up.

4. Stock cannot be issued when a company is initially formed. Shares are issued when a company is formed.

5. Shares are numbered consecutively. Stocks are not numbered. But the names of the stock-holders are recorded in the Books of the Company.

6. Shares can be directly issued to the public whereas stock cannot be issued directly.

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[1] (1878) 10 Ch. App. 154

SCHEMES OF ARRANGEMENT, RECONSTRUCTION AND AMALGAMATION

A Company may find it necessary to settle or compromise with its creditors or with particular groups of shareholders. For this purpose it may be necessary to recognise its structure or to amalgamate with another Company. Sections 391 to 396A of the Companies Act lay down the procedure for such re-organisation and amalgamation. The procedure is summarised below.

I. Schemes for Arrangement

The expression "Arrangement" includes a re-organisation of the share-capital of the Company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods.

A compromise or arrangement may be proposed (*a*) between the company and its creditors or any class of them; or (*b*) between a company and its members or any class of them.

Upon such a proposal being made, the company, or any creditor, or any member, or the liquidator (if the company is in the process of being wound up) may apply to the court for an order directing the holding of a meeting of the members or the creditors concerned.

If in such a meeting the proposed scheme or arrangement is accepted by a majority representing at least 3/4ths in value of the creditors or members concerned, and if thereafter, the scheme is sanctioned by the court, it becomes binding on the company and all parties concerned and the scheme must be given effect to.

The court will not sanction any compromise or arrangement unless it is satisfied that all material facts relating to the company (e.g., its latest financial position) has been disclosed to the Court.

A certified copy of the Court's order is to be filed with the Registrar and annexed to every copy of the memorandum issued subsequently.

When a scheme is sanctioned by the High Court, it shall have power to supervise the carving out of the arrangement and to issue directions concerning the same.

Information of the arrangement shall be given to all persons concerned.

Case Law :

(1) A scheme sanctioned by the Court does not operate as a mere agreement between the parties. It becomes binding on the company, the creditors and the shareholders and by statutory force. But it does not mean that the scheme becomes part of the constitution of the company. *J. K. Private Ltd.* v. *New Kaiser-I-Hind Sp. & Wvg. Co.*[1]

(2) *Who can apply ?* The Court can take action under S. 392 on the application of *any* person interested in the affairs of the company. Such an application is not limited or restricted to a member, the liquidator or the creditor of the company. The Court can also act *suo motu*. *S. K. Gupta and another* v. *K. P. Jain and another.*[2]

II. Amalgamation through the Court

A scheme of compromise or arrangement may involve the amalgamation of one company with another by the transfer of the whole or part of any company to another. In such cases the scheme must be approved by holders of three-fourths in value of the shares concerned and sanctioned by the court. The procedure is the same as that outlined in I above. While sanctioning the scheme the court can facilitate the amalgamation by passing order for any of the following purpose :

(*a*) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company ;

(*b*) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person ;

(*c*) the continuation by or against the transferee company of any proceedings pending by or against any transferor company ;

(*d*) the dissolution, without winding up, of any transferor company ;

(*e*) the provision to be made for any person who, within such time and in such manner as the Court directs, dissents from the compromise or arrangement ; and

(*f*) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

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[1] AIR (1970) Supreme Court 1041 [2] AIR (1979) Supreme Court 734

No compromise or arrangement in connection with a scheme for the amalgamation of a company (which is being wound up) with another company will be sanctioned unless the court receives a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interest of the members or to public interest. A similar report, from the Official Liquidator, is necessary before the court orders dissolution without winding up of any transferor company. [See (d) above].

The court shall give to the Central Government, notice of all applications for sanction of schemes of arangement, composition and amalgamation. The court shall take into consideraion the representation of the Central Governemnt, if any—Sec. 394A.

III. Compulsory purchase of the shares of dissenting shareholders (Sec. 395)

Scheme for 'take over' of shares : Where a scheme or contract involving the transfer of shares of one company to another has been approved by the holders of not less than nine-tenths in value of the shares involved within four months of the date of making the offer, the transferee company may, at any time within two months after the expiry of the said four months, give notice to any dissenting shareholders that it desires to acquire his share. The offer must be sent with full and detailed information.

Upon such notice being given, the transferee company becomes entitled and bound to acquire the shares, within one month of the date of notice, on the same terms as those on which the shares of the approving members are being acquired under the scheme.

A dissenting shareholder may apply to the court within one month of the notice, for an order prohibiting the purchase. The court may do so if sufficient grounds are shown.

The right of compulsory purchase can be exercised when the transferee company already holds a certain proportion of the shares in question.

After the formalities have been complied with and the instrument of transfer has been executed by the shareholders or

by any person appointed by the transferee company, the purchase price of the shares together with instrument of transfer is to be deposited with the transferor company. Thereupon the transferor company shall record the name of the transferee company as the holder of the shares and within one month inform the dissenting shareholders, the fact of such registration and the receipt of the money. The purchase price paid is to be held in trust for payment to the persons entitled to it.

Through the procedure provided by Section 395, it is possible to carry through a scheme of amalgamation, without the assistance of the court.

IV. Amalgamation by Order of Central Government (Sec. 396)

Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, it may, by order notified in the official Gazette, provide for the amalgamation of those companies into a single company with such constitution; with such property, power, rights, interests, authorities and privileges; and with such liabilities and obligations; as may be specified in the order.

The order of the Central Government may contain such consequential, incidental and supplemental provisions as may be necessary to give effect to the amalgamation.

Members and creditors (including debenture-holders) of the original companies shall have, against the new company, as nearly as possible the same rights as they had against the original companies. If the rights and interests of any member or creditor is affected prejudicially by the amalgamation, he will be entitled to compensation, the amount of which will be determined by such authority as may be prescribed. The compensation will be paid by the new company.

Before issuing the order of amalgamation, the Central Government will send a copy of the proposed order in draft to each of the companies concerned and will consider their suggestions and objections if any.

Copies of the order of amalgamation must be laid before both houses of Parliament.

Books and papers of a company amalgamated with or acquired by another company under sections 391 to 396 shall

not be disposed of without the prior permission of the Central Government. They may be examined for evidence of any offence.—Sec. 396A.

ISSUE OF SHARES AT A PREMIUM

A company may issue shares at a premium *i.e.*, at a value greater than its face value. If it does so, it must transfer an amount equal to the aggregate value of the premium received to an account to be called, "the share premium account". Section 78 provides that the share premium account may be applied by the company for any of the following purposes :

(*a*) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares ;

(*b*) in writing off the preliminary expenses of the company ;

(*c*) in writing off the expenses of or, the commission paid or discount allowed on, any issue of shares or debentures of the company ; or

(*d*) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Except for the purposes mentioned above, the share premium is to be considered part of the capital of the company. The provisions of the Act relating to reduction of capital are applicable to the share premium.

ISSUE OF SHARES AT A DISCOUNT

Under Sec. 79 a company can issue shares at a discount, *i.e.*, at a value less than its face value if the following conditions are fulfilled :

(*a*) the issue of the shares at a discount is authorised by a resolution passed by the company in general meeting, and sanctioned by the Company Law Board ;

(*b*) the resolution specifies the maximum rate of discount at which the shares are to be issued ;

[Provided that no such resolution shall be sanctioned by the Company Law Board if the maximum rate of discount specified in the resolution exceeds ten per cent. unless the Board is of opinion that a higher percentage of discount may be allowed in the special circumstances of the case.]

(*c*) not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business ; and,

(*d*) the shares to be issued at a discount are issued within two months after the date on which the issue is sanctioned by the Court or within such extended time as the Court may allow.

Every prospectus, relating to the issue of shares, shall contain particulars of the discount allowed and so much of the discount as has not been written off.

The proviso added in clause (b) was inserted in the Companies (Amendment) Act, 1974.

COMMISSION AND BROKERAGE

Commission

A company can pay commission to a person subscribing to the shares or (debentures) or procuring subscription for them, provided the following conditions are fulfilled.—Sec. 76.

1. The payment must be authorised by the articles.

2. The rate of commission must not exceed in the case of shares : 5% of the issue price or the rate prescribed in the articles, whichever is less ; and in the case of debentures : 2.5% of the issue price or the rate prescribed in the articles, whichever is less.

3. The amount or rate of commission payable, and the number of shares and debentures which have been agreed to be subscribed at a commission must be disclosed in the prospectus or statement in lieu of prospectus.

4. A copy of the contract for the payment of commission must be delivered to the Registrar at the time of delivery of the prospectus, or statement in lieu of it, for registration.

No commission shall be paid on shares or debentures which are not offered to the public for subscription, except where they were subscribed or agreed to be subscribed before the issue of the prospectus or the statement in lieu of it and that fact together with the amount of commission payable is disclosed in the prospectus or statement.

Brokerage

A broker is one who brings buyers and sellers into contract with one another. The rules stated in. Sec. 76 (see above) do

not apply to brokerage paid for the sale of share or debentures. A company is free to pay such brokerage, "as it has heretofore been lawful to pay".—Sec. 76(3).

PURCHASE OF THE COMPANY'S OWN SHARE

A company limited by shares or by guarantee cannot purchase its own shares because such a purchase amounts to a reduction of capital.—Sec. 77(1).

No public company and no private company which is a subsidiary of a public company can give by loan or otherwise any financial assistance for the purchase of its own shares or the shares of its holding company.—Sec. 77(2).

Exceptions : The rule that a company cannot purchase its own shares, is subject to the following exceptions :

1. A company may purchase its own shares if the consequent reduction of capital is effected and sanctioned in accordance with the rules prescribed in the Act for reduction of capital.

2. A company can redeem its redeemable preference shares where it can lawfully do so.

3. This rule does not prevent forfeiture or surrender of shares where lawfully made.

4. The court can direct purchase of shares under section 402 when necessary for protection of the interest of the minority.

The rule that a company cannot finance the purchase of its own shares [Sec. 77(2)] does not imply a prohibition of the following types of transaction :

(*a*) the lending of money by a banking company in the ordinary course of its business ;

(*b*) the provision of money, in accordance with a scheme for the time being in force, for the purchase of fully paid up shares in the company or its holding company, by trustees of employees or for the benefit of employees (the term employee includes a director holding a salaried employment under the company) ; and

(*c*) the making of loans to employees (not exceeding 6 months' wages) for the purchase of purchasing shares in the company or its holding company. (The clause does not apply to loans to directors and manager.)

However, Section 77A of the Companies (Amendment) Ordinance 1998 permits a company to purchase its own shares

(buy back) subject to certain conditions. On the otherhand Sec. 77B prohibits buy back in certain cases.

Buy Back

Notwithstanding anything certained in the Companies Act, 1956 a company may purchase its own shares or other specified securities. This is subject to provisions of Section 77A (2 and Sec. 77B). Thus a company may purchase its own shares or other specified securities from—

(1) out of its free reserves; or

(2) out of the securities premium account; or

(3) out of the proceeds of an earlier issue other than fresh issue of shares made specifically for buy back purpose [Sec. 77A(1)].

Conditions for Buy Back

No company shall purchase its own shares or other specified securities as referred to above unless—

(*a*) the buy back is authorised by its Articles;

(*b*) a special resolution has been passed in general meeting of the company authorising the buy back;

(*c*) the buy back does not exceed 25 per cent of the total paid up capital and free reserves of the company purchasing its own shares or other specified securities.

(*d*) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy back;

(*e*) all the shares or other specified securities are fully paid up.

THE REGISTER AND INDEX OF MEMBERS

Register

Every company is bound to keep a Register of Members in which particulars are entered regarding the name, address, and occupation of the members; the number of shares held by each; the date of commencement and cessation of membership; and similar particulars regarding ownership of stock, where the shares have been converted into stock.—Sec. 150.

Index

Every company having more than 50 members, shall keep an Index of Members, unless the Register of Members is kept in the form of an index.—Sec. 151.

No notice of any trust, express, implied or constructive, shall be entered in the Register of Members.—Sec. 153.

A company may after giving not less than 7 days' notice by advertisement in some local newspaper, close the Register of Members for a period of not more than 45 days in the year and not more than 30 days at a time.—Sec. 154.

Rectification of the Register of Members. (Sec. 155)

In respect of rectification of register the provisions for private company and public company are entirely different. In case of a private company, if name of a person is entired into register of members or deleted from the register of numbers the person to aggrieved or any other member of the company or company itself can apply to the Company Law Board (CLP) for rectification of the register. As the powers of the CLP (Company Law Board) are wirder it can order to rectifications for any reason.

In case of public company, company must register transfer within two months. Transfer cannot be refused without sufficient cause. But rectification can be applied only when transfer is in violation of any law.

The Foreign Register

A company may, if so authorised by the articles, keep in a country outside India, a branch Register of members resident in that country. Such a register is called the Foreign Register. A duplicate of the Foreign Register must be kept in India and a copy of all changes made in the entries must be transmitted to the registered office in India.—Sections 157, 158.

TRUST OF SHARES AND DEBENTURES

Public Trustee

Sections 153A and 153B provide for the appointment of a Public Trustee to whom all persons holding company shares or debentures in trust are to make a declaration. However, under SEBI guidelines, appointment of trustees is mandatory if debenture maturity is 18 months or more.

Voting rights in the company are exercisable, at his option, by the Public Trustee.—Sec. 187B.

Declaration as to shares and debentures held in trust

The holder of a share in, or debenture of, a company, but who does not hold the beneficial interest in such share or debentures, shall within such time and such form as may be prescribed, make a declaration to the company specifying the name and particulars of the persons who hold the beneficial interest of such a share or debentures.

The holder shall declare to the company whenever there occurs a change of beneficial interest of the shares or debentures.

The company shall make a note of such declaration in its Register of Members and shall file the declaration of the Registrar within 30 days from the date of receipt.

If any person required to make a declaration under the above rules and fails to do so without any reasonable excuse, he shall be punishable (fine up to Rs. 1000 per day). If a company or its officer fails to comply with the above provision, who is in default, shall be punishable (fine up to Rs. 100 per day).

If any charge, promissory note or any collateral agreement is created, executed or entered into in relation to any share or debentures by the ostensible owner, or any hypothecation by the ostensible owner of the shares or debentures, when there was no declaration required under the rules, it shall not be enforceable by the beneficial owner or any person claiming through him.

Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend under sec. 206. The obligation, on such payment stands discharged.—Sec. 187C, Companies (Amendment) Act, 1974.

The Central Government may investigate the beneficial ownership in such cases.—Sec. 187D, Companies (Amendment) Act, 1974.

MEMBERSHIP OF A COMPANY

Definition of "Member"

According to Section 41 of the Act, the term "member" of a company means—

(1) the subscribers of the memorandum of the company, and
(2) every other person who agrees in writing to become a member of a company and whose name is entered in its register of members.

How is membership created ?

A person can become member of a company in any one of the following ways—

1. *Signature* : By signing the memorandum of association before it is presented for registration.

2. *Allotment* : By getting an allotment of shares and having his name included in the register of members.

3. *Transfer* : By getting a transfer of shares from an existing member and having the transfer recognised by the company.

4. *Transmission* : By obtaining shares by inheritance from a decreased member and getting his name included in the register of members.

5. *Acquiescence* : By allowing his name to remain in the register of members under such circumstances that he cannot later on plead that he is not a member. A right to disclaim the ownership of shares on legal grounds must be exercised within a reasonable time. If a shareholder makes inordinate delay he will be prevented from doing so on the doctrine of holding out. Lord Cairns in *Sewell's case.*[1]

Member and Shareholder

In companies having a share capital, a shareholder is also a member of the company. In companies, not having a share capital, there are members but no shareholders. "The terms 'member' and 'shareholder' are synonymous, apart from the now exceptional case of the bearer of a share warrant who is shareholder but is not a member because he is not registered in the register of members." (Palmer's Company Law, 21st ed., p. 439)

The words, "member", "shareholder", and "holder of a share" have been used interchangeably in the Companies Act. The expression, "holder of a share" denotes, in so far as the company is concerned, only a person who, as a shareholder, has his name entered in the register of members. *Howrah Trading Co.* v. *I. T. Commissioners.*[2]

Transfer and Transmission of Shares

When shares pass from one person to another by a voluntary act *e.g.*, by sale, gift or otherwise, it is called transfer. When

[1] (1868) 3 Ch. App. 131 [2] AIR (1959) Supreme Court 775

shares pass by operation of law from one person to another, *e.g.*, by inheritance, it is called transmission.

On the death of a member, his shares vest in his executors or administrators or other legal representatives, and such shares are liable for calls if the shares remain partly paid. *Baird's Case.*[1]

Who can be a member ?

The Companies Act does not prescribe any qualification for membership of a company. But since membership is created by agreement, it may be argued that persons incapable of entering into contracts cannot be members.

Minor : An agreement by a minor is void in India. Therefore a minor cannot apply for and be a member of a company. If a minor has, by mistake, been recorded as a member, the company can rescind the transaction and remove the name from the register. The minor can also repudiate the transaction and get his name removed, from the register. But where a minor was made a member and, after attaining majority, he received and accepted dividends, he will be estopped from denying that he is a member. *Fazalbhoy* v. *The Credit Bank of India.*[2] *Sadik Ali Khan* v. *Jaikishore.*[3] (See p. 53).

Company : A company can be a member of a company. But a subsidiary company cannot be a member of its holding company, except where the subsidiary company comes in as the legal representative of a deceased member.—Sec. 42.

Creditor : A person to whom shares have been transferred by way of security, becomes a member of the company and is liable as such.

Fictitious person : It is a punishable offence to apply for allotment of shares, or for the registration of transfer of shares, or for the registration of transfer in a fictitious name.—Sec. 68A.

Trustee : A company will not register notice of any trust. A trustee who buys shares will be treated as a member in his individual capacity.—Sec. 153. But see 'Trust of Shares', pp. 634-635.

How membership ceases

The membership of a person in a company may terminate in any one of the following ways :

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[1] (1870) 5 Ch App. 725
[2] 39 Bom. 331
[3] AIR (1928) Privy Council 152

1. *By death* : When a member dies the ownership of the shares passes to his successors. The successors will, on production of evidence of ownership, be registered as members in place of the deceased member. But a company may have, under the articles, a right to refuse to recognise the successors as members.

2. *By insolvency* : Upon insolvency of a member, the shares vest in the Official Assignee or the Official Receiver.

3. *By rescission* : The contract to purchase shares may be rescinded. A person who has purchased shares may under certain circumstances have the contract rescinded, *e.g.*, when there are untrue statements in the prospectus. Upon rescission, he ceases to be a member.

4. *By forfeiture* : Shares may be forfeited according to the provisions of the articles.

5. *By a surrender* : Shares may be surrendered where surrender is permitted.

6. *By transfer* : Shares may be transferred.

7. *By sale* : Shares may be sold in execution of a decree of the court.

8. *By power of lien* : Shares may be sold by the company in exercise *of a power of lien* over it for the dues of the company.

9. *By a mortgage* : Where shares are mortgaged and according to the terms of the mortgage, the shares have been transferred to the mortgagee, the latter can have his name registered as a member. It he does so the original member loses his membership.

10. *By redemption* : Preference shares may be redeemed.

11. *By winding up* : When the company is wound up according to the provisions of the Act, membership ceases to exist.

TRANSFER OF SHARES

Shares may be transferred in the manner provided for the purpose in the articles of the company and subject to the restrictions contained in the articles. The Companies Act contains the following provisions regarding transfer of shares.

1. Documents

[Section 108 (1)] A company shall not register a transfer unless the following documents are produced before it :

(*a*) a proper instrument of transfer duly stamped and executed

by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, and

(*b*) the certificate relating to the share, or if no certificate is in existence, the letter of allotment.

The instrument of transfer is not required in cases of transmission of shares by operation of law but the company may require evidence of transmission.

The above provisions also apply to the transfer of the interest of a member in a company which has no share capital.

As per Section 113(1), shares must be transferred within two months after the issue of the certificate. The paid can be extended to 9 months by the Company Law Board if there are sufficient reasons. CLB can also urge the company to make good the default, of any, and to bear all costs incidental to the application process in this respect.

2. The prescribed form

(Sec. 180 (1A)] Every instrument of transfer of shares shall be in the prescribed form.

(*a*) It must be presented to the prescribed authority, (being a person in the service of the Government) before it is signed by or on behalf of the transferor. The prescribed authority will stamp or endorse thereon the date of presentation.

(*b*) If the share is one which is dealt with in a recognised stock exchange, the instrument of transfer shall be delivered to the company any time before the next closing of the register of members or within two months from such date of presentation, whichever is later. In other cases the instrument of transfer shall be delivered to the company within two months from the date of presentation to the prescribed authority. The Central Government may extend the periods mentioned above.

In certain exceptional cases, a transfer must be accepted by a company, even though the above requirements are not complied with.

(*c*) The provisions stated above do not apply to shares deposited (as security for a loan or for the performance of an obligation) to the State Bank of India, any scheduled bank or any banking company or financial institution approved and notified by the Central Government.

3. Lost Instrument

If the instrument of transfer is lost, the directors may allow the transfer, on such terms as to indemnity as they think fit.

4. Share of a deceased member

The legal representative of a deceased member can transfer shares, although he is not himself a member.—Sec. 109.

5. Who will apply for transfer ?

An application for the registration of transfer may be made either by the transferor or by the transferee. Where the application is made by the transferor and relates to a party paid up share, the company must give notice to the transferee (by post) and the transfer can be registered only if the transferee makes no objection within two weeks of the time he ought to have received the notice by post.—Sec. 110.

6. Refusal

The articles may empower the company to refuse to register a transfer or transmission of shares.—Sec. 111(1). In cases of such refusal, the applicant is to be notified within two months.—Sec. 111(2).

Section 111 of the principal Act has been amended in 1988. The amended section provides that if a Company refuses to register the transfer of or transmission of the right to any shares or debentures of the Company it shall send notice of the refusal within two months giving reasons for such refusal.

The transferor or transferee may appeal to the Company Law Board against any refusal of the Company to register the transfer.

Such appeal must be made within two months of the receipt of notice of such refusal.

The power of refusal must be exercised reasonably and in good faith. (See the cases below).

7. Appeal against refusal to transfer [Sec. 111(3) to 111(9)]

A. *In the case of a public company and a private company which is a subsidiary of a public company.* The transferor or the transferee or the person who gave intimation of the transmission may appeal to the Central Government against the company. The appeal must be filed within two months of the

receipt of the notice of refusal, or where the company fails to give any notice, within two months after the expiry of the period within which such notice should have been issued. The appeal must be by a petition in writing and shall be accompanied by prescribed fee.

The Central Government shall give an opportunity to the appellant, the previous owner, if any, and the company to represent their case. The Central Government may require the company to disclose the reasons why transfer was refused. If the company fails to disclose the reasons, the Central Government may presume that the disclosure, if made, would be unfavourable to the company.

The Central Government may reverse the decision of the company or confirm it. In the former case, the company must register the transfer within 10 days of the receipt of the order. The Central Government may also order the payment of costs to the aggrieved party.

All proceedings connected with the appeal shall be confidential. No suit shall lie concerning any allegation made in such proceedings.

B. *In the case of other private companies.* In such cases, the decision of the company to refuse registration cannot be challenged, except in one case. If any shares of such a company are sold in execution of a decree or the orders of a public authority and the purchaser's name is not registered, he can appeal to the Central Government. Such an appeal is dealt with in the same manner as an appeal against a public company (See above). There is, however, an additional provision for such cases. The Central Government may give an option to the company, either to accept the purchaser as a member or to get the shares purchased by a member of the company at a reasonable price to be determined by the Central Government.

RESTRICTIONS ON ACQUISITION AND TRANSFER OF SHARES

The Companies (Amendment) Act of 1974 enacted the following restrictions on acquisition and transfer of shares.

1. Restrictions on the acquisition of shares

Except with the previous approval of the Central Government, a group or any constituent of the group must not, jointly or

severally, acquire or agree to acquire, which exceed 25% of the paid up equity share capital (together with the shares already owned) of the company under the same management. The rule is applicable to a public and also a private company which is a subsidiary of a public company,. Any person who acquired any share in contravention of this provision is published (Up to 3 years' imprisonment and/or fine up to Rs. 5,000)—Sec. 108A. (Definition of 'Group'—See p. 548)

2. Restrictions on transfer

Any body corporate or bodies corporate under the same management holding, (whether singly or aggregate) 10% or more of the nominal value of the subscribed equity shares shall (before transferring one or more such shares) intimate the Central Government with all particulars. On receipt of the intimation, if the Central Government is satisfied that as a result of such a transfer, a change in the composition of the Board of directors of the company is likely to take place and that such a change will be prejudicial to the interest of the company or the public interest, it may by order direct that,

(*a*) no such share shall be transferred to the proposed transferee or,

(*b*) in certain "listed industries" such share shall be transferred to the Central Government or to a corporation owned or controlled by the Government.

In case of transfer, the transferee must be paid in cash according to its market value. Any contravention of this section may be punished by imprisonment up to 30 years and/or fine up to Rs. 5,000.—Sec. 108B.

The term "market value" means the value as quoted on any recognised stock exchange. If such a share is not quoted in a stock exchange, market value means the value agreed between the shareholder and the Central Government or the specified corporation. In the absence of such an agreement its value will be determined by the Court.

A "listed industry" means an industry listed in schedule XII of the amended Act. Some examples are Air transport, Coal, Iron and Steel, Antibiotics etc.

If the Central Government does not make any direction, within 60 days from the date of receipt of its intimation, the provisions regarding transfer shall not apply.

3. Restriction on the transfer of shares of foreign companies

No body corporate or bodies corporate under the same management, which holds, or hold in the aggregate, 10% or more of the nominal value of the equity share capital of a foreign company, having an established place of business in India shall transfer any share in such foreign company to any citizen of India or any body corporate incorporated in India except with the previous approval of the Central Government.

Such previous approval shall not be refused unless the Central Government is satisfied that such transfer would be prejudicial to the public interest.—Sec. 108C.

Contravention of this section is punishable.

4. Central Government can direct companies not to give effect to the transfer

Where the Central Government is satisfied that as a result of the transfer of any share or block of shares of a company, a change in the controlling interest of the company is likely to take place and that such change is prejudicial to the interests of the company or to the public interest, the Government may direct the company not to give effect to the transfer of any such share or block of shares.

The transferee of such shares will not exercise voting or other rights, including that of any nominee or proxy of the transferee.

Where the transfer of share or block of shares is not allowed by the Central Government, the sale price shall be refunded to the transferor. Such an order may be enforced as if it were a decree of the Civil Court.

If the transfer is allowed, the transferee will be eligible to exercise voting or other rights.—Sec. 108D.

5. The time of refusal

Every request made to the Central Government for according its approval to the proposal for the acquisition of any share or the transfer of any share shall be presumed to have been granted unless, within a period of 60 days from the date of receipt of such request, the Central Government communicates to the person by whom the request was made, that the approval prayed for cannot be granted.—Sec. 108E.

6. Penalty

Any person who exercises any voting rights or other rights contravenes the provisions of Secs. 108A, 108B and 108C shall be punishable (up to 5 years imprisonment and also fine). The company and every officer is punishable by fine up to Rs. 5000 and up to 3 years' imprisonment.—Sec. 108F.

7. Some Exemptions

Nothing contained in section 108A, section 108B, section 108C or section 108D shall apply to the transfer of any share to, or by,—

(*a*) any company in which not less than fifty-one per cent of the share capital is held by the Central Government :

(*b*) any corporation (not being a company) established by or under any Central Act ;

(*c*) any public financial institution specified by or under section 4A. (See p. 548)

CASE LAW CONCERNING TRANSFER OF SHARES

Effect of Transfer

A transfer of shares remains incomplete until the transferee's name is registered. Pending registration, the transferor is trustee of the shares for the transferee. *Hardoon* v. *Belilios*.[1]

A transferee, not replying to a notice of transfer by the company, is not estopped from denying the validity of the transfer. *Barton* v. *L & N. W. Rly. Co.*[2]

Companies Act (1956), S. 108—Whether mandatory or directory : Negative, prohibitory and exclusive words are indicative of the legislative intent when the statute is mandatory. Negative words are clearly prohibitory and are ordinarily used as a legislative device to make a statutory provision imperative. The words "shall not register," are mandatory in character. *Mannalal Khetan etc. etc.*, v. *Kedar Nath Khetan and others, etc.*[3]

Power to refuse registration

Where directors have power to refuse registration of a transfer the power must be exercised in a *bona fide* and just manner. *Re Coalport China Co.*[4]

A member of a company has an unfettered right to transfer the shares to another person, unless this right is taken away by the Articles ; and

[1] (1901) A.C. 118
[2] (1888) 38 Ch. D. 144
[3] AIR (1977) Supreme Court 536
[4] (1895) 2 Ch. 404

a transferee under a valid transfer has an absolute right to be registered unless the company has a power to refuse to register. *Rangpur Tea Assn.* v. *M. Samaddar*[1]

Where the directors under the articles of a company have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, discretion does not mean a bare affirmation or negation of a proposal. Directors will act for the paramount interest of the company and for the general interests of the shareholders. The directors are therefore required to act *bona fide* and not arbitrarily and not for any collateral motive. *Bajaj Auto Ltd.* v. *N. K. Firodia*[2]

In the case of private companies there may be restriction of the rights of members to transfer their shares. In a company the Articles provided that a share can be transferred only to male relatives, that is sons or brothers and their lineal descendants. The House of Lords did not object to such restrictions. *I. R. C.* v. *Crossman*[3]

Central Government, when exercising powers under S. 111, is a tribunal within the meaning of Art. 136 and is required to act judicially. It has to be decided whether the directors have acted oppressively, capriciously, corruptly or *mala fide*. *Harinagar Sugar Mills Ltd.* v. *Shyam Sundar Jhunjhunwala*.[4]

If the Board of directors had refused a transfer and on appeal the decision was reversed and the transferee was later on again registered, the transferee is entitled to damages on the basis of the fall in a market price of the shares and between the date of refusal to register and the date of suit. Where there was no fall in a market-price, the transferee would be entitled to nominal damages only. *Thenappa* v. *Indian Overseas Bank*.[5]

Forged transfers

If the instrument of transfer is forged and the company in good faith issues a certificate to the "transferee", the title of the real holder is not affected. The transferee's name may be removed from the register on appropriate steps being taken. *Barton* v. *L. & N. W. Rly. Co.*[6] If the "transferee" sells the shares to a *bona fide* purchaser for value, the purchaser gets no right to be a member of the company but he is entitled to damage from the company for having issued a share certificate on the basis of a forged instrument of transfer. *In re Bahia & San Francisco Rly. Co.*[7]. The company is entitled to get damages from the person who induced them to issue share certificate on the basis of a forged instrument of transfer. *Sheffield Corporation* v. *Barclay*.[8]

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[1] (1972) 76 C.W.N. 393
[2] AIR (1971) Supreme Court 321
[3] (1937) A.C. 26
[4] (1962) 2 S.C.R. 339 Supreme Court
[5] AIR (1943) Mad. 743
[6] 24 Q.B.D. 77
[7] (1868) 3 Q.B. 584
[8] (1905) A.C. 392.

LODGING THE CERTIFICATE

When a person is the owner of a number of shares, the company issues only one certificate in respect of all the shares and not one for each share. It follows that when the holder transfers some of the shares he owns he has to deposit the share certificate with the company for the issue of a fresh certificate for the balance of the shares that remains in his ownership. When a certificate is deposited for this purpose the company writes on the instrument of transfer the words "certificate lodged" or other similar words. The original certificate is thereafter corrected and a fresh certificate issued.

BLANK TRANSFERS

Blank transfer of shares may be (*i*) by way of mortgage, and (*ii*) by sale.

A blank transfer is an instrument of transfer of shares, in which the name of the transferee is not mentioned. Whoever has the instrument he has the implied authority of putting in his own name or the name of any other person as the transferee. An application can be made to the company to record the person, whose name is finally put on the instrument, as a member of the company. The utility of a blank transfer is that a single instrument can be used for several sales. The procedure can avoid stamp duty.

A sells some shares to *B*, giving him a blank transfer, *B* can sell the shares to *C* by simply handing over the instrument to *C*. *C* can transfer the shares to *D* in the same way. *D*, if he wishes to be recorded as member can write down his own name on the transfer form and apply for registration.

The handing over of a transfer form executed in blank, does not by itself authorised the person to whom the form has been transferred to sell the share or get himself registered as the owner. Thus, if a person borrows money on the security of a share and gives to the lender the share together with a transfer form signed in blank, the lender is not entitled to sell the share except for non-payment of the amount lent.

In the case of a blank transfer, equities exist between the transferor and the transferee and the transferee has the right to claim the dividend from the transferor who holds it in trust for

him, but the company is only liable to the transferor and not to the transferee. Though the transferee is clothed with an equitable ownership, he is not a full owner. *Howrah Trading Co. Ltd.* v. *Commissioner of Income-Tax.*[1]

CALLS

The Companies Act provides that not less than 5% of the face value of a share must be paid with the application for the purchase of the share. The balance of the purchase price is payable in the manner laid down in the articles.

Suppose that the face value of a share is Rs. 100. Five per cent of this, *i.e.*, Rs. 5 is payable with the application. The balance Rs. 95 is payable upon allotment, or partly upon allotment and partly when demanded by the company. It may be provided that the company will demand the balance by a number of "calls" at different times. When the company demands payment of any part of the purchase price payable in this fashion, it is said to made a "call".

Rules

The requisites of a valid call are stated below.

1. *Notice* : The decision to make a call must be taken by the Board of Directors and notified to the shareholders concerned under Section 292(1) (a)(b).

2. *Time and amoumt* : The resolution of the Board must state the amount to be paid and its time.

3. *Interest* : The Articles of the company usually provides that in case of default, interest is to be paid by the shareholder.

4. *Uniformity* : Calls shall be made on a uniform basis on all shares falling under the same class, *i.e.*, there must be no discrimination in favour of any shareholder.—Sec. 91.

5. *Advance call* : A company may, if so authorised by the articles, accept an advance payment of any part of the money due (*i.e.*, before any call has been made).—Sec. 92. Such advance payment does not entitle the shareholder to any extra voting power. But a company may, if so authorised by the articles, pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others.—Sec. 93.

6. *Call is a debt* : When a call has been validity made, it becomes a debt due from the shareholder and the money can be recovered by suit.

7. *It must follow* SEBI rules.

8. *Legal decisions* : The formalities laid down in the articles regarding the making of calls must be scrupulously complied with. A call made in contravention of the provisions of the articles is invalid. *Re Cawley & Co.*[1] But irregularities of a trifling nature do not matter. *Dowson* v. *African Consolidated Co.*[2] The power to make calls is of a fiduciary nature and must be exercised for the benefit of the company. *Lomb* v. *Sambas Rubber Co.*[3] The call-making power is in the nature of trust and this power should be exercised for the benefit of the company. *Alexander* v. *Automatic Telephone Co.*[4]

LIEN

The articles of a Company may provide that the Company shall have a lien or first charge on the shares of a member for moneys due from him to the Company. In such cases if any share is mortgaged, the claims of the Company on the share, if any, will have priority over the claims of the mortgage.

The lien on the shares, where it exists, extends also to the dividends payable on the shares and the assets receivable by the shareholder upon winding up. In *Allen* v. *Gold Reefs.*[5] it was held that the company's lien continues after the death of the shareholder.

The articles usually empower a company to enforce its lien by a sale of the shares. But a lien cannot be enforced by forfeiture of shares. The lien is not a possessory lien, but creates an equitable charge, which is assignable. *Everett* v. *Automatic Machine.*[6]

Loss of lien

A company losses lien if—(1) it registers a transfer of shares subject to the lien of the transferee.

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[1] (1889) 42 Ch. D. 209
[2] (1898) 1 Ch. 6
[3] (1908) 1 Ch. 845
[4] (1900) 2 Ch. 56
[5] (1900) 16 Ch. 656
[6] (1892) 3 Ch. 506

(2) A member pledges his shares to a third party for a loan and informs the company, then pledgee gets priority over the lien of company.

FORFEITURE OF SHARES

The articles may provide that the shares of a shareholder can be forfeited under certain circumstances, *e.g.*, non-payment of calls.

Rules

The following rules, regarding forfeiture of shares, are generally provided for in the Articles of a Company :

1. The decision of forfeiture of the share must be made by the Board of Directors.

2. A notice must be issued to the holder, demanding to pay the call within a fixed period usually 14 days on default of which the share will be forfeited.

3. On forfeiture, the Company becomes the owner of the shares and they can be sold to others.

4. Upon forfeiture the original shareholder ceases to be a member and his name must be removed from the Register of Members.

5. The forfeited shares can be sold at any price.

6. A forfeiture is not valid unless the power to forfeit the shares has been strictly and literally complied with. *Pramila Devi* v. *People's Bank of N. India.*[1]

7. The power to forfeit is in the nature of a trust and must be exercised for the benefit of the company.

8. The purchaser of a share, forfeited for non-payment of calls, is liable to pay all unpaid calls due on the share. The company cannot sell a share free from the liability to pay calls. The original holder of the forfeited share remains liable as an ordinary debtor for the unpaid calls according to the provisions of the articles and can be sued for the debt.

9. There is nothing in the Companies Act, 1956, which prevents a company from forfeiting the shares of any member for non-payment of any money due to the company other than

[1] AIR (1938) Privy Council, 284

money due for payment of calls. Under the articles of association, the Exchange has the authority to sell the forfeited shares and to appropriate the sale proceeds towards the satisfaction of the debts, liabilities or engagements. *Naresh Chandra Sanyal* v. *Calcutta Stock Exchange Association Ltd.*[1]

However, shares issued as fully paid shares cannot be forfeited as in *K. Md. Farooq Ahmed* v. *Fortarn Cirkit Electronics P. Ltd.* (1997)

SURRENDER OF SHARES

Surrender of shares means abandonment of the shares by the holder thereof in favour of the Company. There is no provision in the Act or in Table A for surrender of shares. But the articles of a company may provide for the acceptance of a surrender under circumstances which would justify forfeiture.

The surrender of shares by a member to the company becomes valid—

(1) Where the Articles empower the directors to accept it and it is accepted, in case of partly paid shares, to save the company from going through the formalities of forfeiture.

(2) Where it is in accordance with the Articles and accepted in case of fully paid shares in exchange for new shares of the same nominal value and the surrendered shares are capable of re-issue.

Surrender amounts to a reduction of capital. Therefore, the articles can provide for the acceptance of surrender under circumstances which would justify forfeiture. Any provision in the articles, for the acceptance of surrender in other circumstances, is invalid. *Madras Native Fund* v. *Natesa Sastri.*[2] ; *Bellerby* v. *Rowland and Marwood S. S. Co.*[3]

A valid surrender of shares justifies in case of forfeiture. *Trevor* v. *Whitworth.*[4]

The Articles of a company may provide that certain specified shares may be surrendered in exchange of new shares to be issued by the company.

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[1] (1972) 1 S.C.A. 172 (Supreme Court)
[2] 52 Mad. 915
[3] (1902) 2 Ch. 14
[4] (1887) 12 A.C. 409

EXERCISES

1. Explain the concept of 'Capital' in relation to a limited company and state the various senses in which the term 'Capital' is used in company law. (Pages 613-616))
2. State the voting right of a shareholder in a Company Meeting. (Pages 616-617)
3. State the rights, duties and the liabilities of a shareholder. (Pages 617-619)
4. Explain how the share capital of a company can be increased. What are Rights Shares ? (Page 620)
5. Write explanatory notes on : (*i*) Schemes of Arrangements (*ii*) Reconstruction and (*iii*) Amalgamation. (Pages 626-629)
6. What are the modes of acquiring and cessation of membership of a company ? (Pages 636-638)
7. What is the law relating to restrictions on the purchase of own shares by the company ? (Pages 632-633)
8. "Shares are *prima facie* transferable." Discuss. (Pages 638-641)
9. State the rules regarding registration of transfer of shares of a Company. (Pages 638-641)
10. State the remedies available to person for refusal or failure of directors to register the transfer of shares. (Pages 642-644)
11. State whether a loan can be converted into the shares of the company. If it can be done, then at what time and what is the procedure ? (Page 622)
12. State the rules regarding issue of shares at a premium and at a discount. (Pages 630-631)
13. State the differences between the following :
    (*a*) Equity Shares and Preference Shares. (Pages 614, 616)
    (*b*) Member of a Company and a Shareholder. (Page 636)
    (*c*) Share Certificate and Share Warrant. (Pages 623-624)
    (*d*) Shares and Stock. (Pages 624-625)
    (*e*) Transfer of Shares and Transmission of Shares. (Pages 636-637)
14. Write notes on the following :
    Share ; Redeemable Preference shares ; Register and Index of members ; Reserve Capital ; Trust of shares ; Public trustee ; Lodging the certificate ; Blank transfers ; Calls ; Lien on the shares ; Forfeiture of shares ; Surrender of shares. (Pages 613 ; 619 ; 634 ; 578 ; 634 ; 635 ; 635 ; 646 ; 646 ; 645 ; 647 ; 646)
15. Objective Questions.
    (*a*) What is Capital ? (Page 613)
    (*b*) What is convertible debenture ? (Page 736)
    (*c*) Are the shareholders of a Company the proprietors of the company ? (Page 613)